

THE POLITICAL ECONOMY OF CURRENCY
TRANSACTION TAXES

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ABSTRACT

The speculative currency transaction markets are the largest capital markets in the world with an estimated US\$2 trillion being traded every day. By comparison the daily global transactions related to international trade, goods and services represent only a small proportion of capital trades. Speculative flight in times of capital crises has triggered major social and economic disruptions such as those in Mexico (1994), East Asia (1997 - 98) Russia (1998), Brazil (1999), Turkey (2000) and Argentina (2001). Smaller crises occur regularly including currency speculation losses by the Reserve Bank of Australia in 2002 and corporate disruptions from trading losses incurred by the National Bank of Australia in 2004. Recently (May 2006) hedge funds withdrew vast quantities of capital from Iceland and New Zealand causing major disruptions to financial systems in both countries. Each disruption causes trauma to small and institutional investors and to civil society.

The proliferation of transactions and the rise in accommodating and secretive offshore tax havens has created a global shadow economy, which has essentially reconfigured capitalism in modern times. This paper examines the political economy of financial market reform and the financial architecture required to implement a currency transaction tax. The thesis defends an argument in support of global currency transaction taxes based on proposals originally made by Keynes, Tobin, Spahn and Schmidt. There is an urgent need to account for the effects created by the speculative and volatile global shadow economy. Recent developments in hedge fund regulation measures demonstrate that the lobbying power of new financial players create major problems for policymakers and global financial security.

ACKNOWLEDGEMENTS

No piece of research is an individual achievement. John Maynard Keynes made the first known suggestion for a currency transaction tax and this suggestion was internationalised by James Tobin.

In compiling this paper I have been assisted by Dr. Fred Gale, Professor Aynsley Kellow and Dr. Marcus Haward of the University of Tasmania's School of Government. I am grateful for their recommendations and their grace.

My late sister Sally and the late Premier of Tasmania, Jim Bacon gave me inspiration to attempt this work.

AUTHORITY TO ACCESS

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LIST OF ACRONYMS

ARCH	Autoregressive Conditional Heteroscedasticity
ATTAC	Association pour une Taxation des Transactions Financiers pour L'Aide aux Citoyens
BBS	British Bankers Association
BIS	Bank for International Settlements
CEO	Chief Executive Officer
CLS	Continuous Link Settlement Bank
CTT	Currency Transaction Tax
EEC	European Economic Community
EMS	Exchange Rate Mechanism
FRB	Federal Reserve Bank
FSF	Financial Stability Forum
GST	Goods and Services Tax
HNWI	High Net Worth Individuals
IMF	International Monetary Fund
IT	Information Technology
LTCM	Long Term Capital Management
MAI	Multilateral Agreement on Investments
MDG	Millennium Development Goals
NGO	Non Government Organisation
NAB	National Australia Bank
OECD	Organisation for Economic Cooperation and Development
OTC	Over the Counter trading
TTO	Tobin Tax Organisation
UN	United Nations
UNDP	United Nations Development Program
US\$	United States Dollars

1. INTRODUCTION

This paper examines the need for, and feasibility, of a currency transaction tax. It argues that underlying financial market forces produce major economic and social dislocations when states fail to regulate volatile global financial markets. The study highlights the emergence (over the past three decades) of a new paradigm in global financial markets—one that diverges from traditional financial markets that relied on real trade in goods and services and long term structural investment, to one where major financial players (banks and finance companies) engage in trading currencies and massive investment in hedge funds. These trades are primarily executed through offshore facilities located beyond state regulation, resulting in the rapid expansion of trade volumes and the growth of these offshore centres.

In investigating the political economy of global financial markets I contend that there is an urgent need to regulate speculative and volatile currency transactions.

Regulatory controls over offshore, unregulated, currency market activities are debated with greater frequency during times of financial crises. The most recent incident that focused public attention on capital controls occurred during the “Asian Crisis” in 1997 and 1998; however, there have been episodic crises since then that have caused major social and economic disruption in many states. Political pressure for transaction taxes continues, with Belgium becoming the first state to introduce legislation to enable currency transaction taxes, in July 2004, and Spain investigating proposals. In this paper I examine the global political economic issues around currency trading, within a framework that highlights the tensions that exist between states and financial market actors.

The new financial instruments have weakened traditional share markets as major capital volumes are diverted to high-risk speculative markets. Such a restructuring of the capital market has been promoted by stakeholders lobbying governments and political leaders, who in consequence inadequately protect their domestic economies. Whilst an array of institutions report and produce technical data on global trade, there are relatively fewer analyses of global currency market policy. Virtually no over-riding international policies are in existence.

This paper reviews the prudential regulations that shape the conduct of financial traders, and examines the feasibility of proposals for foreign currency transactions, which have become prominent. Concomitant with a rising number of major global currency market failures has been the deregulation of national finance systems and the globalisation of economic markets. Tensions exist between governments seeking some degree of regulatory control over financial flows, and the finance industry pushing for unregulated currency markets based on a neo-liberal, “self-correcting” paradigms.

I argue for a logical, regulatory global financial architecture that provides protection for investors and the public and develop the thesis that although strong public calls for financial regulation have not been heeded by policymakers, there is a need to examine the current situation nonetheless and look at implementing arrangements to alleviate the massive social and financial dislocations that will inevitably arise from foreseeable future crises. A stable money supply is a public good, and policymakers who ignore these issues do so at a considerable risk to the functions of civil society.

The argument centres on the demonstrated fragility in global capital markets and the emergence of powerful traders who operate largely outside public scrutiny, unregulated in their trading environment, and who lobby governments to protect their position. I argue for the need to re-regulate, impose a miniscule tax on traders, and put in place a global safety net to counter this volatile, foreign currency speculation. I examine the unwillingness of global leaders, (operating under neoliberal ideologies) and under sustained pressure from the financial industry, to make decisions on capital controls and effective financial governance.

This paper demonstrates how regulatory authorities could force tax havens to adhere to global governance procedures in respect to transparency in currency and hedge fund trades; and how the newly formed Continuous Link Settlements (CLS) bank could administer a currency tax collection procedure. I detail the massive social and economic costs to states and the global financial system (estimated at US\$255 billion each year) of taking no action.

To prove the thesis, I draw extensively on contemporary journals and books to define the critical issues with respect to currency markets. I also employ data from several documentaries that have been released from the United States about the problems with unregulated markets as well as the a video published by War on Want featuring the British politician Gordon Brown, who argues in favour of taxation proposals to hold players to account in this rapidly escalating market. For hard, quantitative data, I have drawn on information from the Bank for International Settlements and Reuters to provide and create tables and charts that detail the structure and composition of foreign exchange markets (in Chapter two). Theoretical reflections on the nature of speculative global financial markets and their relationships with states has been informed by the works of Strange, Underhill, Quiggin, Stiglitz, Singh, Soros, and Helleiner, and is set out in Chapter three.

I provide solid research material to back claims in respect the perceived threats from buoyant and ungoverned capital markets from reputable economic and financial magazines and newspapers such as *The Economist*, *The Bulletin*, and the *Financial Times*. The timeliness of the recent data and material in *The Economist* in particular has been especially useful in respect to the importance that this particular magazine places on current developments. *The Economist* regularly comments on capital markets, hedge funds, derivatives and the sphere of global political economy. I have researched hedge fund and derivative sites on -line. This information has been important in respect to recent movements in Europe to place discussions on currency transaction taxes high on the list of political importance.

The thesis is structured as follows. Following this Introduction, Chapter Two provides an overview of the development and growth of financial markets, which give rise to arguments in favour of capital control measures. The negative consequences of ungoverned currency markets, and exchange rate trends and market participants are examined, as are the actors—dealers, brokers and clients—involved in the global financial market. This chapter sets the scene for a consideration of theoretical approaches to global financial market regulation.

Chapter Three examines theoretical approaches to the tensions that exist between states and capital interests, and asserts that the growth and influence of international financial markets has been assisted by the reluctance of policymakers to regulate or control volatile capital flows. The chapter outlines the theories of Strange, Underhill, Quiggin, Helleiner and others, and investigates how capital volatility has had a destabilising influence in many countries throughout the world. Virtually no controls have been implemented to impede free-flowing global capital movements. States are reluctant to make choices to lessen the impact of powerful, global, financial players that include most national banks in the developed world. This chapter also examines the proliferation of offshore tax havens and the problems associated with unregulated and non-compliant shelters.

Chapter Four examines the technical feasibility of CTT proposals arguing that the models promoted by Tobin, Spahn and Schmidt are realistic and feasible. It compares and contrasts the three different proposals, examining in detail how such a tax would work in practice and how the different scenarios would involve raising different amounts of money. The chapter concludes that a CTT is technically feasible, and that the obstacles to its implementation are largely political. This then leads us, in Chapter Five, to examine the political feasibility of CTT proposals. In this Chapter, I outline the growing popular pressure for such a tax, as well as the various initiatives that have occurred in Belgium, Canada, France, the United Nations, and elsewhere in its support. This chapter also looks at resistance to CTT's (and any other moves to regulate capital) from the three main trading states, the United States, the United Kingdom and Japan. While averting financial instability and crisis is a prime motivation for a CTT, governments have also begun to perceive important revenue raising potential to fund other global commitments related to the war on terror, emergency relief and projects under the Millennium Development Goals.

In Chapter Six, I conclude by recapitulating the central argument of the thesis that rising volumes and increased volatility justify taking immediate steps to introduce a CTT for the purpose of regulation, revenue for public goods, and integrity of financial systems. Economists and commentators have warned of the risk of destabilising the structure of the global financial system. The Conclusion summarises the main issues related to instability with trades, and the theories and practical proposals at hand to remedy the situation.

2. FINANCIAL MARKETS: GROWTH, VOLATILITY AND DYSFUNCTION

INTRODUCTION

Upheavals in global financial markets have occurred with increasing intensity. Financial market volatility in Europe, Russia, the United States of America (US), Mexico, and most recently, in Southeast Asia and Argentina, have caused considerable anxiety to policymakers and created both social and financial disruption on a global scale. The closer global financial markets come to genuine integration the more centrally they act in absorbing and challenging the political authority of states. As a consequence, the volatility of currency trading, hedge funds, fund of funds and derivatives markets represents an emerging and persistent problem. Financial commentators have been driven to use the word “revolution” to compare past financial paradigms to powerful financial market integration models that have developed over the past two decades. Integration of global financial markets is the main driver of unilateral trade agreements.

Potential disruptions to financial markets and social dislocation are evident in the problems currently being experienced between the US and China where the recent partial float of the Chinese Yuan has eased the critical situation of having the Yuan “pegged” to the US dollar. By averaging annual growth of 9.5% for almost three decades, China has lifted hundreds of millions out of poverty in the most rapid economic transformation in history (*The Economist* 29 October 2005:13). The balance of trade surpluses in favour of China continue to pose critical non-market issues between both countries. There is very strong evidence of an emerging tension between these states, in much the same way that tensions existed between the US and the emerging, rampant “Asian Tiger” economies in the mid- to late-1990s. Major US distribution corporations such as Wal-Mart now source their products from China to capture the advantages of low-cost labour. Manufacturing in the US in some sectors has all but ceased to the detriment of American workers.

Some estimates put the average daily trade in global capital flows as US\$2.3 trillion (BIS and CLS 2005). Exact figures are difficult to estimate as large volumes originate from tax havens. It is impossible to measure precisely the size of speculative or unnecessarily volatile capital flows because often any particular type of financial transaction can be used for more than one purpose. Nevertheless, one indication is foreign exchange trading which, at over US\$2trillion per day, has grown faster than one would expect if it were only used for non-speculative purposes. There are indications, discussed below, that more and more financial actors are engaging in foreign exchange trading for speculative purposes.

Around 83 percent of these global trades were in US dollars; 59 percent of global foreign exchange reserves are held in US dollars. At the centre of global currency markets are prominent investment and commercial banks, with agencies that connect legitimate trading centres with traders and dealers who operate outside of regulative authority. All operate on the assumption of inherent instability in global currency and capital markets. It is these instabilities that create the necessary trading positions and margins.

In this chapter, I provide a detailed account of the structure, operation, and potential consequences of global financial markets, highlighting their dysfunctional effects and promoting the need for some level of re-regulation. I describe the development of global financial markets, which were reinvigorated by floating international exchange rates following the collapse of the Bretton Woods financial system. The new regime of independent floating currency rates encouraged strong increases in volumes, and types of trading mechanisms, in global financial markets. At the same time major risks became apparent with the unique spread and scope of speculative capital trades and the dangers associated with the invasive nature of global currency trades. States began to lose controls on inflows and more importantly, outflows, of “footloose” capital. Most problematic has been the inability of states to deal with cross-border transactions under the influences of high technology driven exchange mechanisms.

The development of global financial markets has also seen the proliferation of tax havens as the preferred base of operations for market traders and actors. The rise in

the number and influence of tax havens has made currency trades opaque, allowing actors to secrete and launder funds which would otherwise be available to, and under the control of, states. Capital transaction secrecy is aided and promoted by international accountancy firms. These new speculative capital dynamics have now become an almost insurmountable obstruction to states that have fostered and sponsored their growth for three decades. These are markets that James Tobin referred to as “adrift without anchors” (Tobin 1978:153).

This chapter investigates the problems associated with the rapid development of financial markets and provides an analysis of exchange rate data, and information about global speculative capital markets. Trade volumes highlight levels of sustained market growth and trends in currency market trades, but behind this data lie the main actors: managers of hedge funds, fund of funds, mutual funds and central banks and brokers, bankers and corporations and high wealth individuals. In drawing out the risks and consequences inherent in ungoverned global markets, the chapter concludes that systemic dysfunctions evident in the Southeast Asia financial meltdown in 1997 and the Long Term Capital Management debacle in 1998 are an ever present danger, serving to remind us of how burgeoning markets can, and do fail, despite the best efforts of states to ward off speculative crises. Currency transaction problems have occurred in Australia which is the sixth largest global trader. These crisis scenarios are often raised by critics of the un-regulated and un-governed global financial system.

DEVELOPMENT OF GLOBAL FINANCIAL MARKETS

The move to floating international exchange rates occurred during the break -up of the Bretton Woods system of fixed parities amongst major international currencies. This market reintegration triggered a massive increase in global foreign exchange capital in the 1970s. The post-Keynesian period created a favourable climate for the freeing of international capital flows. New regimes in finance included the floating of currencies, deregulation of capital markets, lowering and abolishing of tariffs, production for export rather than an emphasis on financing import replacement, a significant lowering of taxes to business and a concomitant regressive system of consumption taxes for the populace.

The immediate dilemma facing states with a history of capital market integration, and for emerging capital market states that are being urged to embrace global economic systems, is that there is a risk of impending disaster following outward runs of unregulated capital. The question central to the debate is whether there should be more or less regulation. If one country, particularly one of the eight key capital market players, pushes for tighter regulatory arrangements, will that country then be immediately passed-by in favour of those countries offering no regulation or transparency on capital movements? Joel Bakan (2004:150) argued that:

Regulations are designed to force corporations to internalise, i.e. pay for costs they would otherwise externalise onto society and the environment. When they are effective and effectively enforced, they have the potential to stop corporations from harming and exploiting individuals, communities and the environment. Deregulation is really a form of de-democratisation, as it denies 'the people' acting through their democratic representatives in government, the only official political vehicle they currently have to control corporate behaviour.

This position is being circumvented in part by the proliferation of offshore tax havens, the existence of which takes the issue away from regulation proponents. This creates a double problem for policymakers who have regulation or tax considerations in mind. Do they look at a tax proposal from the state level that would create an incentive for traders to leave their shores? Or should they be content with a 'do-nothing' approach when the capacity for calamity is only seconds away in the form of a major capital run? Many states (Germany, France, Canada, Belgium, Japan and Britain and Spain) are suggesting they are in favour of re-regulation in the form of a Tobin-type tax providing other countries agree to implement it on a global basis. Other states (including the US) resist such proposals in any shape or form.

In addition to this global political problem, policy makers also confront the "impossible trinity" described by former US deputy treasury secretary Larry Summers (*The Economist*, September 21-28, 1999). The 'trinity' is in respect to sovereignty, regulation of markets and market integration. That is, those who wish to regulate capital markets and maintain national sovereignty must do so at the expense of capital market integration. Those who wish to maintain sovereignty and to allow capital markets to integrate must accept all the conditions pertaining to an entirely

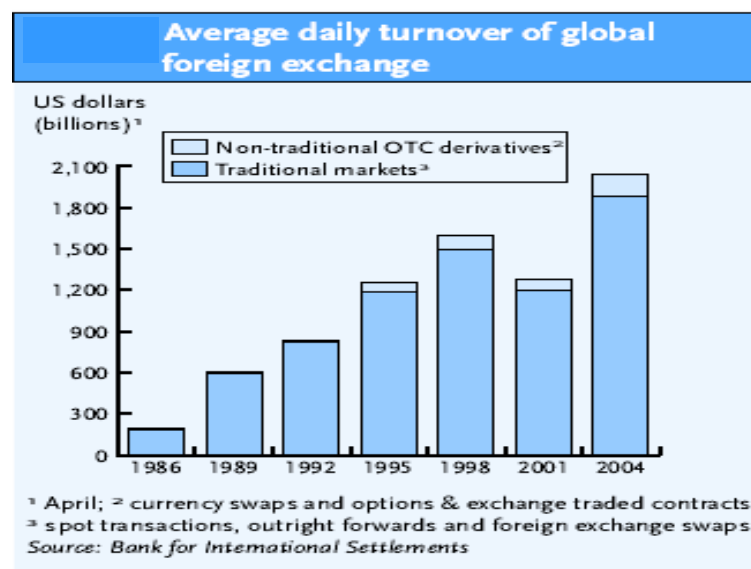
free market at the global level. Those who desire capital market integration and global regulation must entirely forfeit national sovereignty.

This “impossible” trinity renders most radical economic architectural blueprints utopian since most politicians and policymakers are not prepared to choose only two of the three objectives. The conclusion is that the best way forward is to devise incentives to make market participants stick to current state-specific regulatory rules and to then investigate those proposals on currency taxes by Tobin, Spahn, Schmidt, Denys and others. Such adherence to improved global regulatory rules would have the effect of reducing the risk of further financial crises even within a world of sovereign states.

GLOBAL CAPITAL MARKETS

Today, financial markets are at record trading levels and there is an unprecedented volume of public money now being used to create wealth through non-traditional means. At a time when the United States dollar fluctuates daily, other states including China and states in Southeast Asia are accumulating massive dollar reserves, it is pertinent to look at the amounts of capital in the market and how the markets operate. Figure 2:1 provides the rapid growth in speculative capital markets.

Figure 2.1: Average daily turnover of global foreign exchange



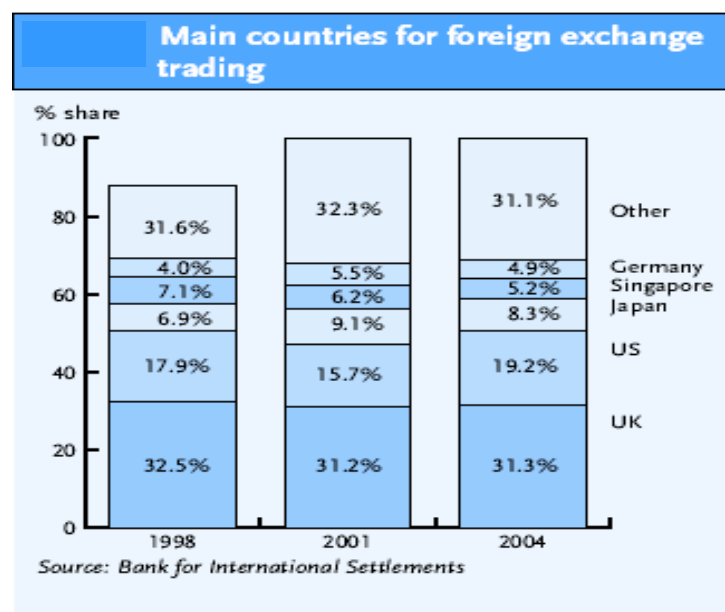
As Figure 2.1 depicts, there has been a massive growth in the turnover of global foreign exchange since 1986, with recent growth coming from non-traditional trades. The triennial survey by the Bank for International Settlements shows the average daily turnover close to US\$2 trillion per day. Since these figures were released there has been a continual increase in volumes and some sources now suggest that this average figure is being exceeded. The phenomenal rise in volumes from the 2001 figure indicates a major reduction immediately following September 11 events in the United States. The US\$2 trillion represents fifteen times the size of the combined daily turnovers on all of the world's equity markets. Foreign exchange trading is now seen as "an asset class" and reflects significant growth in hedge fund capital. Foreign exchange instruments include spot transactions, outright forwards and foreign exchange swaps which account for nearly 92% of the April 2004 figure (see Table 2.1). Currency swaps and options generated 6.9% of turnover and foreign exchange futures and options traded on derivatives exchanges made up the balance.

Table 2.1: Global foreign exchange and derivatives markets (US\$ billions)

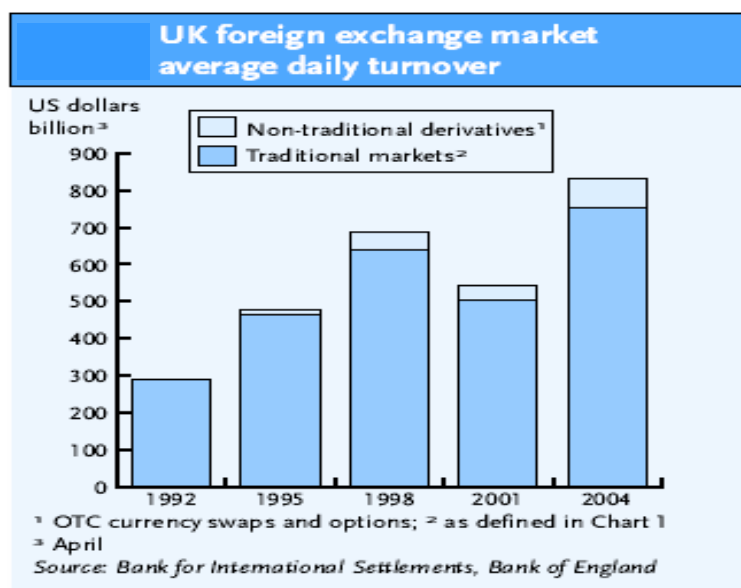
Type of transaction	1995	1998	2004
Traditional foreign exchange	1190	1490	1835
Spot transactions	520	590	660
Outright forwards & forex swaps	670	900	1100
Currency derivatives	45	97	115
Currency swaps	7	10	12
Options	41	87	113
Interest rate derivatives	151	265	305
FRAs	66	74	83
Swaps	63	155	198
Options	21	36	45
Other	1	1	1

Source: Bank of International Settlements, 2003. April 1998 and April 2004 figures show average daily turnover in billions of US dollars; notional amounts shown for derivatives.

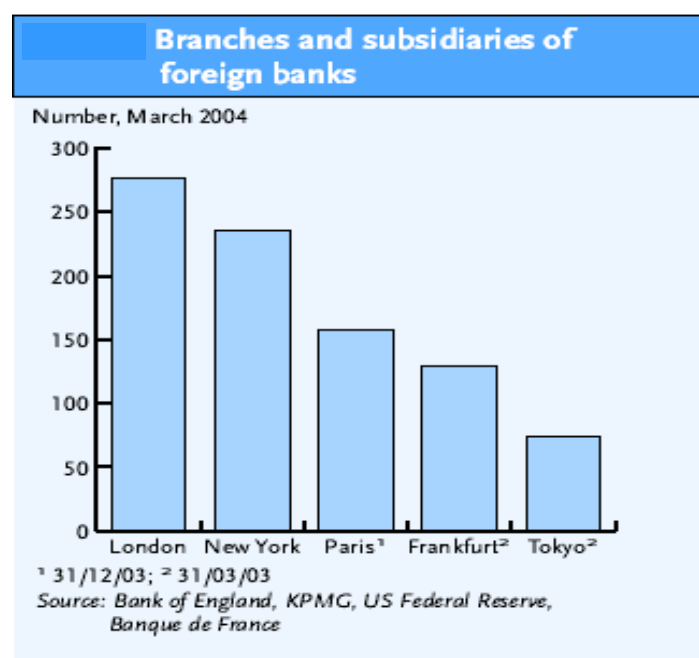
Foreign exchange is an over the counter (OTC) market where brokers and dealers negotiate directly with one another—there is no central exchange or clearing house. The main geographic trading centres, which handle nearly two-thirds of all foreign exchange transactions, are in the UK (primarily within the City of London, with 31% of global turnover), the United States (19%), Japan (8%), Singapore (5%), and Germany (5%). As Figure 2.2 shows, most other trades are transacted in Switzerland, Australia (the eighth largest global trader), Canada, France, and Hong Kong.

Figure 2.2: Main countries for foreign exchange trading

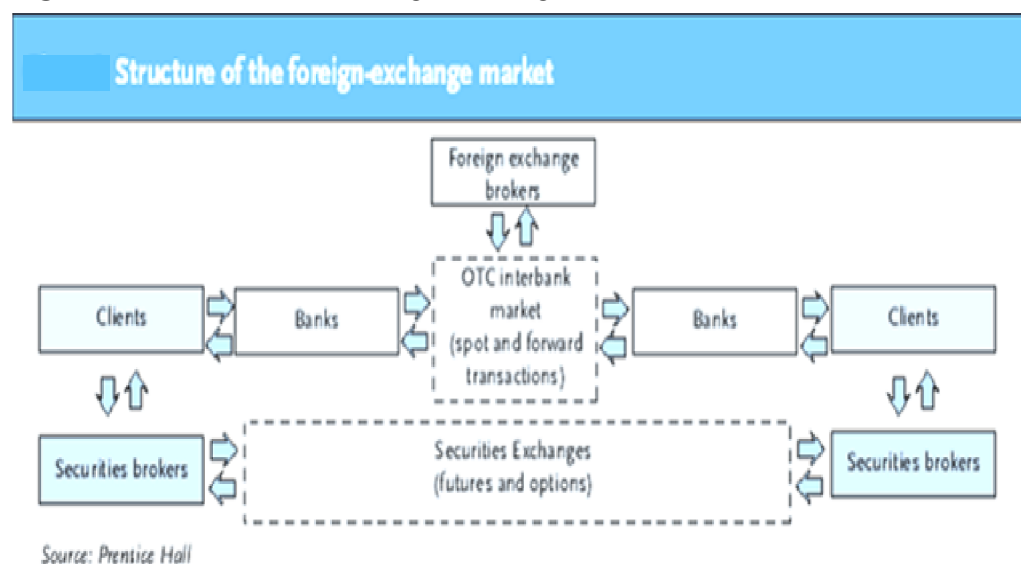
The centre for global trading is the City of London. Afforded off shore status by the Thatcher government in the early 1980's in a move to deregulate the finance industry in the United Kingdom, the City of London has consistently maintained its top ranking for speculative financial trades and financial investment. The average daily turnover in the foreign exchange market is US\$753 billion (Figure 2.3). There is more trading in US dollars in the United Kingdom each day than there is in US dollars in the whole of the United States. Likewise more euros are traded in the London foreign exchange markets than in the whole of Europe. The average daily turnover in the City of London in 2004 was up a massive 54% over that of March 2001. Foreign owned institutions (United States 45%, EU 14%) accounted for 72% of foreign exchange trading in London during the period to March 2004.

Figure 2.3: UK foreign exchange market average daily turnover

The centrality of the City of London is its main advantage, as it is strategically located between United States and Asian time zones (Figure 2.4). There is also a (government supported) tradition and historical base of welcoming and encouraging foreign firms and trading houses to locate to the City. High quality professionals with strong financial expertise staff the firms. The City of London provides a focus in IT infrastructure and corporate accommodation. The concentration of foreign institutions in one centre is unrivalled anywhere in the world. The City of London is Europe's main centre for prime-brokerage services, which facilitate the burgeoning hedge fund capital management. The markets in foreign exchange trading have risen to the top of the financial business in London.

Figure 2.4: Branches and subsidiaries of foreign banks

In the past, most countries supported their currencies with convertibility to gold as the standard measurement device. This was known as the “Gold Standard” and later the “Gold exchange standard” and until the early seventies was at the centre of the global financial system. The Bretton Woods accord in July 1944 fixed gold at 35 dollars per ounce and other countries’ currencies were fixed to the dollar. This “peg” came under increasing pressure as national economies moved in different directions during the 1960’s. In 1971 the President of the United States, Richard Nixon, suspended US dollar convertibility to gold and in 1973 the Group of Ten industrialised countries allowed their currencies to “float” against each other. In 1978 the free-floating system was introduced. A few years later in Australia, the Prime Minister Bob Hawke initiated moves to deregulate the economy. Under this new regime, capital owners became more aggressive in global markets and new systems of trading were devised to take advantage of deregulation and new opportunities to secrete money through evasion schemes and tax haven proliferation. Foreign exchange speculation became the big new game in town and this trading has increased with the cooperation of the state ever since.

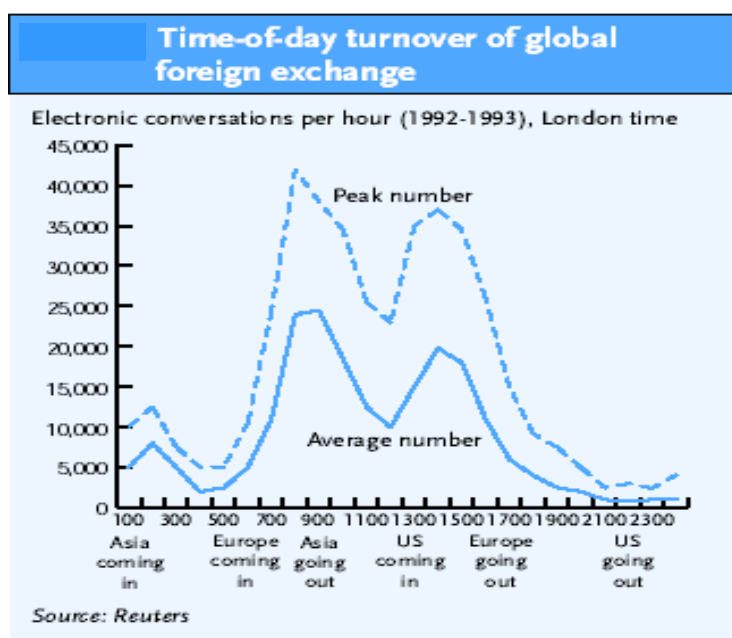
Figure 2.5: Structure of the foreign-exchange market

The operation of the foreign exchange market is outlined schematically in Figure 2.5. Foreign exchange is the transfer of funds from one country and currency to another country and currency. New currencies are added to the list regularly: New Zealand, for example, had its dollar registered as a tradable currency in December 2004. The exchange rate applicable to a trade is the number of units of one currency that buys a number of units of another currency. The market exchange is determined by the interaction of the official participants in the market (governments) and private buyers and sellers. The foreign exchange market consists of a large number of actors including banks, multinational corporations, pension fund managers, exchanges and private individuals.

The Interbank market is a wholesale market that does not have a centralised point or agency of trading. The Bank for International Settlements and the Continuous Linked Settlements agencies monitor and register trades and increasingly the finance operations section of the OECD has been active in demands that traders register their participation in the market place to offer some transparency to the system. The BIS provides estimates of the types and volumes of trades and trends.

Traditional foreign exchange markets consist of commercial and investment banks and other financial institutions which handle spot, outright forwards and foreign exchange swaps on the Over the Counter (OTC) market. These dealers developed into an Interbank market for foreign exchange through their frequent inter-bank dealings with each other as they nurtured and developed buyers and sellers in the market. In 2004 there are estimated to be more than 2000 dealer institutions worldwide. Mergers and acquisitions, and partnerships, have seen numbers decline since the mid-1990s, but trading volumes have increased enormously. The dollar is by far the most widely traded currency and was involved in 89% of all trades in 2004, followed by the euro (37%), the Japanese yen (20%), pound sterling (17%), the Swiss franc (6%) and the Australian dollar (5%). Because two currencies are involved in each transaction the sum of the percentage shares of individual currencies totals 200%. The share of sterling in the global market doubled between 1995 and 2004 (BIS 2004).

Figure 2.6: Time-of-day turnover of global foreign exchange



The foreign exchange market is a 24-hour market, which operates across all global time zones. The trading day begins in Asia, extends into Europe and then overlaps with the United States. Figure 2.6 shows trading activity is highest when major markets overlap, particularly early in the morning in Europe and at the opening of

the North American markets. In foreign exchange every position involves buying one currency and selling another so as long as there are movements in the exchange rate the potential for profits or losses exist. Leveraged positions in the market are high. Banks now entice domestic market participants into the market with offers of credit to become players. Traders can take long or short positions, as outlined below.

LONG AND SHORT POSITIONS

Foreign exchange trading means the simultaneous buying of one currency, and selling of another. The currency of one country is exchanged for that of another. The currencies are always traded in pairs such as US Dollar/Japanese Yen (USD/JPY), Euro/US Dollar (EUR/USD), and Great Britain Pound/US Dollar (GBP/USD). More than 80% of daily foreign trading involves major currencies like Australian Dollar (AUD), British Pound, Canadian Dollar (CAD), Japanese Yen, Swiss Franc (CHF), and the US Dollar. Foreign exchange trading is not centralised on any exchange, and trading moves from major banking centres like Wellington, Sydney, Japan, London and New York – in that order.

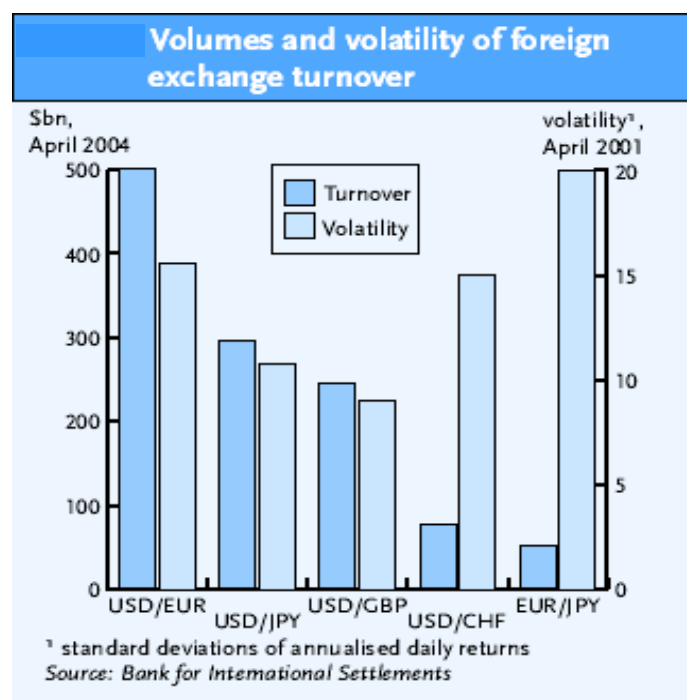
In foreign exchange trading, there is a bid price and an ask price, and the difference of the two is called the spread. The “bid” is the price at which buyers are willing to buy, and the “ask” is the price that sellers are willing to sell at any given time. The prices are always 5 digit numbers, irrespective of where the decimal point is placed. For example, EUR/USD has a bid price of 1.2641 and an ask price of 1.2644, thereby yielding a 3 “pip” spread. In another example, the USD/JPY bid price is 107.09 and ask price is 107.12. A transaction takes place when one currency is on the up, and another is going down. Choosing the right currency will ensure a profit.

The margin is the name of collateral (prices seen side by side) for a position. If the market moves downward, the foreign exchange trader will ask the investor for additional funds by way of a “margin call”. In case of insufficient funds, the trader will close the open positions immediately. A “long” position is one in which the investor buys a currency at one price, with the expectation of selling it later at a higher price. A “short” position is one in which the investor sells a currency with the expectation of buying it back at a lower price, expecting the currency to fall. Every foreign exchange trading position taken means that the investor has gone long in one

currency, and short in the other. Leveraged positions can translate into as little as one or two percent of the equity base with the balance borrowed.

Foreign exchange has developed into an asset class (a type of investment such as stocks or bonds) over the past decade. This is partly due to it being uncorrelated to any other asset class. A survey published by Greenwich Associates showed that on average 40% of banks, 30% of fund managers and over half of hedge funds traded foreign exchange as an asset class in 2003. The larger the trader, the more likely it would be to be engaged actively in forex trading. Traditional trading instruments generated 92% of foreign exchange transactions in the April 2004 BIS Survey (BIS 2004).

Figure 2.7: Volumes and volatility of foreign exchange turnover



Foreign exchange trading is by nature speculative. Speculators are attracted to the opportunity that exists as numbers and positions change the exchange rates of currencies in normal market conditions. Such volatility is endemic in the market, as evident in Figure 2.7. Some traders take on positions on a leveraged basis, which magnify market movements. Speculators create their own market conditions (herd intuition), with some estimating that as much as 95% of all foreign exchange is speculative. Political and economic conditions can influence the value of exchange

rates. These political and economic conditions can sometimes not be tied in any way to the basic economic conditions prevailing with any state. Governments often participate in the foreign exchange markets to influence the value of their currencies. For example a government may purchase or sell to adjust exchange rates.

RECENT EXCHANGE RATE TRENDS

The volatility of the US dollar against the other major currencies (the euro and the yen) has been higher than the ratios between the dollar and the British pound sterling. In the period between the launch of the euro in 1999 and mid 2000 the dollar appreciated against most major currencies. Since 2001 the dollar has been on a downward trend against the other currencies, whereas the euro weakened for a period and has trended upwards over the years 2001 to 2004 and carried this trend through early 2005. The volatility and subsequent decline of the dollar has been the standout feature of the global currency market in recent times.

Commenting on the seriousness of the problems associated with the declining dollar, *The Economist* stated:

The dollar has been the leading international currency for as long as people can remember. But its dominant role can no longer be taken for granted. If America keeps on spending and borrowing at its present pace, the dollar will eventually lose its mighty status in international finance. And that would hurt: the privilege of being able to print the worlds reserve currency, a privilege which is now at risk, allows America to borrow cheaply and thus spend much more than it earns, on far better terms than is available to others... If you had been granted that ability, you might take care to hang on to it. America is taking no such care, and may come to regret it. The dollar has fallen by 35% against the euro and by 24% against the yen in the three years from 2001 to 2004. But its slide is a symptom of a worse malaise: the global financial system is under great strain (*The Economist* December 4, 2004).

The United States is paying the price for indulgence and habits that are “inappropriate”. These include rampant government borrowing, unprecedented consumer spending and tax give-backs to the wealthy all of which are generating an enormous current account deficit “big enough to have bankrupted any other country”(*The Economist* December 4 2004).

Looking at the potential problem from a global political economy perspective, *The Economist* suggests that the second major problem with the financial markets is that the United States of America has become “a giant money press with an easy money policy that has spilled outside its borders”. Facilitating this process is the burgeoning and under-governed foreign currency transactions market that takes care of the circulation of at least one trillion dollars around the globe every day.

Total global liquidity is growing faster than at any other time in history. Emerging economies that endeavour to “peg” their economies against the US dollar find that they are forced to amplify the US Federal Reserves’ “super-loose monetary policy” (when central banks buy dollars to hold down their currencies and print local money to do so). “This gush of global liquidity has not pushed up inflation. Instead, it has flowed into share prices and houses around the world, inflating a set of asset price bubbles” (*The Economist*, December 4, 2004).

Reports that overseas investors (particularly Japan and other Southeast Asian countries) will continue their strategy of financing the deficit in the US are questioned as trends are now indicating that investors have already turned away from dollar assets as returns on investments are lower than in Europe and Asia where economies are booming as the Asian Tiger economies have reasserted authority on the global scene following the “meltdown” in 1998. *The Economist* (December 4, 2004) asks “can a currency that has been falling against the world’s next two biggest currencies, for 30 years, be regarded as safe?” It also observes: “If the dollar falls by another 30%,... it would amount to the biggest default in history: not a conventional default on debt service, but default by stealth, wiping trillions off the value of foreigner’s dollar assets”.

ACTORS IN THE GLOBAL FINANCIAL SYSTEM

There are a large number of actors in the global financial system. In this section, I focus on six key players: dealers, brokers, clients, hedge funds, fund of funds, and the Continuous Link Settlement (CLS) Bank.

Dealers

Interbank dealings relate to the majority of foreign exchange transactions and are carried out by telephone or electronic brokerage systems. They occur between commercial and investment banks which trade amongst themselves around the globe and on behalf of clients. As stated above, interbank relations and company/bank relations often have connections to clients with small portfolios and capital. The all-encompassing nature of foreign exchange trading is now fanning out and promoted through extensive internet sites to include small investors.

Trades by dealers are to fill customer orders. Banks and trading houses share credit relationships and limits on client accounts. Banks trade on their own account too and as has been mentioned central banks participate in significant volume trades. The Australian Reserve bank lost A\$ two billion in one negative trading episode in 2002.

Dealers trade in all major currencies and cross-trades using forwards, options, and swaps and act on customer's behalf in researching markets for appropriate trade risk options. Interbank trading was responsible for 53% of trading in the BIS April 2004 survey. The volume of trading reflects the need for banks to follow up trades with further customer-related multiple transactions to readjust the banks position through hedging and offsetting the risks involved. Inter-dealer trading has dropped away over the past decade due to the advances in technology, which has reduced the risk for intermediaries. The largest volume in foreign exchange trading is through banks. Deutsche Bank, UBS, and Citigroup accounted for more than a third of trading in 2003. This was up from a 22% position by the three banks in 2000 (*Financial Times* 2004), and is consistent with other volume rises in capital markets.

Brokers

The role of the broker in the interbank relationship is to bring together a buyer and a seller of a currency in return for a commission on the transaction. The broker will create a quote on a currency with a spread that includes the fee. Whereas a dealer on one side (the buyer or the seller) may commit their capital, a broker does not take a position and relies on the commission for the broker service. A broker is an individual or firm that acts as an intermediary between buyer and seller. Foreign exchange brokers are firms that deal in foreign exchange. The foreign exchange market is quite similar to the equity markets except that typical foreign exchange brokers do not charge a commission. However foreign exchange brokers are required to have a license. Foreign exchange brokers earn money from the spread or “pip” as noted above.

Foreign exchange brokers can be compared on a basis of the spread they charge. Most publish live or delayed prices on their websites so that the investor can compare the spreads. Variable spreads appear small and attractive when the market is quiet, but when a market gets busy the foreign exchange broker widens the spread, meaning that the investor will gain only if the market is favourable. Brokers are usually tied to central banks, large banks, or lending institutions. This is because of the huge sums of money traded in the foreign exchange markets. In the United States they are required to register with the Futures Commission Merchant (FCM), and are informally regulated by the Commodities Futures Trading Commission (CFTC). In Australia they are required to register with the Australian Prudential Regulation Agency (APRA) and the Australian Securities and Investment Commission (ASIC). An emerging trend among brokers is the facility of online foreign exchange brokers, who offer trading facilities to “retail traders” using advanced technologies. With these facilities anyone with a computer and an internet connection can trade in the speculative capital markets. Moreover, these facilities often emanate from tax havens. On-line facilities have grown spectacularly in recent times.

Clients

Clients include central banks, corporations, fund managers and individuals and account for 47% of foreign currency turnover. Over the past three decades the rapid increase in investment in speculative currency financial assets has overtaken any other trade. Institutional investors, hedge funds, fund of funds, and other fund managers are major participants in foreign exchange markets, as well as an increasing number of high and medium wealth individuals.

Corporations engage in currency trades either individually or in consortium with specialist foreign exchange trading companies who specialise in offering currency payment and hedging services to corporations. Increasingly private banking corporations are becoming involved in the currency markets which offer high level risks and boast high level returns.

Clients are often corporate executives who were not deterred by the individual entry conditions of at least \$1 million equity to gain a trading place. Restrictions on who can trade in forex markets have been relaxed in recent times from the seriously rich to the more average players who have the resources and the energy to trade through the trading firms which offer services through the internet. The explosion in numbers of hedge funds is a reason for the apparent downgrade in membership equity requirements.

An example of the type of services available is that offered by GFT (Global Forex Trading) on its internet sight. The lead paragraph says:

Fluctuating exchange rates have been increasing profit margins for companies for years now. Global Forex Trading provides the core services corporations need to address their foreign currency exchange demands. Whether you are a chief financial officer or a smaller corporation who deals with foreign clients, distributors or just need to know the basics of forex volatility, we offer services that save you time and capital.

Fees are high for clients but this is the market that everybody seems to want to engage in, even though there are known to be very high risks and reports of many investors losing capital.

Central Banks

Central banks are major players with access to significant capital reserves. Central banks may participate in the foreign exchange markets for many reasons. These are to speculate and take a risk to make further capital, to influence exchange rate dynamics, or to accumulate, reallocate or reduce their foreign exchange reserves. Many central banks handle large amounts of foreign exchange transactions for the government or public sector enterprises. Since the advent of the flexible exchange rate system in 1973 governments and central banks such as the Federal Reserve Bank in the United States occasionally intervene to maintain stability in the foreign exchange markets. If needed central banks have the ability to work together, but monetary authorities are reluctant to intervene to counteract the fundamental forces in the global foreign currency marketplace.

Hedge Funds

The first hedge fund started in New York in 1949. Hedge funds are now estimated to have capital assets of US\$1.3 trillion. They operate in unregulated and ungoverned markets in an environment of high volatility. Hedge funds are restricted by law to no more than 100 investors; the minimum contribution is typically US\$1 million however this requirement seems to have been relaxed, presumably by internal policy. Some hedge funds operate with leveraged positions in the derivatives market. Most hedge funds are highly specialised. The performance criteria are not linked to relative value strategies or market conditions (i.e. the fundamentals of a state economy), unlike equity or mutual fund markets, which are usually subject to 100% exposure with market risks.

Investment in hedge funds is favoured by sophisticated investors, central and private banks. Increasingly hedge funds entice new investors via online domains. Hedge fund performances can seriously affect markets as evident in several high-profile recent cases. Hedge funds are currently growing at 20% per annum. Hedge fund holdings were US\$500 billion in 2001 and they are now US\$1.3 trillion (Reuters 21/3/06 and 29/3/06). This unregulated industry has grown at an incredible rate despite warnings and client losses.

Hedge funds are based at the offshore facilities of London, New York and Tokyo and in a maze of smaller centres including tax havens. They are currently unregulated although moves are afoot for hedge funds to register their dealings through the Securities and Exchange Commission in the United States.

Fund of Funds

Fund of funds generally mix and match hedge funds and other pooled investment instruments. They blend strategies and asset classes and aim to provide a more long term stable investment than individual hedge funds. Capital preservation is the underlying strategy in volatile markets. Fund of funds is a rapidly rising sector of trades and its growth is consistent with the massive amount of capital being invested with hedge funds. Like hedge funds, fund of funds investment returns, and acceptable risk parameters, vary widely. In recent times major superannuation and mutual funds investments are pouring investment into hedge funds and then are overlaid into fund of funds.

Fund of funds is a private equity sector that, instead of being used to make direct investment in companies, is distributed among a number of other private equity fund managers, who in turn invest the capital directly. Fund of funds often give individual limited partners access to funds from which they would otherwise be excluded. Also, by spreading the capital more widely the risk to limited partners is reduced.

The Continuous Link Settlement (CLS) Bank

The CLS Bank began operating in 1993. The CLS Bank is the first autonomous global settling utility specialising in foreign exchange transactions and has over 55 member central banks and over 110 member customers (participants) who are representative of the major foreign exchange dealers and transactors around the world. The CLS settles on live (real time) instructions from traders and operates its settlement linking mechanisms on cross-border payment instructions. These financial trades take place in a five-hour time “window” of over-lapping global bank business hours in what is called Real Time Gross Settlement (RTGS) systems.

Instructions for an allocated date and time are agreed and funds are requested to be paid in, and are paid out, by the CLS Bank to complete the transaction. By a system known as Payment Versus Payment (PVP) each party's accounts are simultaneously credited creating a juncture when a currency transaction tax could be enacted. There is little doubt that the CLS has radically changed global inter-bank dynamics. The CLS Bank (2004) boasts that the new advances offered by their organisation "represent (the most) dramatic change in settlements for over 300 years". These allow for payments to be made out of central bank funds. The CLS estimates that payments made to its banks represent 70% of the total trades in all international foreign exchange and exchanges in derivatives and other instruments on a global scale.

THE CONSEQUENCES OF UNGOVERNED MARKETS

As long ago as 1953, Friedman argued that problems in foreign exchange markets under fixed parity models are properly attributable to inconsistent domestic policies. In his view a system of floating exchange rates is inherently unstable because underlying domestic monetary and fiscal policies are unstable. Friedman used as an example the surges in capital flows, which tended to amplify the appreciation and depreciation of both nominal and real exchange rates. These pressures on state and financial markets evolved relatively slowly over the period between the early fifties and the early 1980's when more political emphasis to free economic regimes allowed for increased competition in emerging deregulated markets. The rise of new forms of instruments for financial trades driven by derivatives trading and hedge funds had a pronounced influence on both volume and ease of trade through computer technology. Today hedge funds are worth US\$1.3 trillion dollars and there is an increasing nervousness about their unregulated activity. Exchange rates are major micro and macroeconomic issues.

The incidence of political and economic instability in the face of capital inflows and outflows has been an ever-present dynamic in global political economy and directly accounts for disruption and crises. Most evident amongst major crises have been Germany (late 20s), the Republic of Korea (1960s), Chile (1970s), Italy (1980s), Mexico (early 1990s), Russia (mid 1990s), and East Asia (late 1990s) and Argentina (ongoing) and the Long Term Capital Management crisis in the United States. In

each case capital flowed to these states from institutional speculative investors looking for mostly short and some long-term capital gains. When large volumes of capital started to flow outwards, the host countries were unable to defend their currencies and social, economic and political chaos and financial dislocation swiftly followed. Most dramatic was the financial and social dislocation from the Southeast Asian Crisis.

The Southeast Asian Crisis

The Southeast Asian crisis of 1997 is a classic lesson of modern economics, with state financial systems imploding under the force of un-regulated speculative capital runs. It began with an attack on the currency of Thailand. This currency attack rolled into a contagion as it influenced neighbouring regional states. The series of events has been described as the major state versus capital showdown of recent times. In terms of financial and social disruption it is without parallel. The immediate effect on the region was to curtail the development of the “miracle Southeast Asian Tiger economies” which prior to this event were heavily promoted and resourced primarily with capital from the United States. This crisis was to set new social and economic conditions in the region and its influence was felt globally. Evidence-informed summaries all agree on at least one point, which is that the massive withdrawal and unimpeded outward capital runs plunged the region into turmoil (Haggard 2000, Noble and Ravenhill 2000).

Thailand alone, in its defensive battle to shore up its currency (the Baht) in the heat of the speculative attack, lost \$US 30 billion. From the Thai losses speculative hedge funds and powerful investment banks from the United States and England earned up to US\$ 8 billion (Patomaki 2001).

Underlying economic structural conditions in Thailand and regional states highlighted the vulnerability of rapid economic growth based on excessive amounts of foreign credit. Commentators cited extreme cases of corporate cronyism and poor management, particularly in the banking industry as an underlying cause of the crisis. This exposed the over-valuation of Thailand's and other regional currencies and promoted a loss of confidence. From this situation an unprecedented run on its currency proved to be unstoppable without effective controls or appropriate policy

settings, or governance. This situation created a climate for the largest financial “correction” in history through the vehicle of unregulated capital trades.

The destabilisation of economies in the Southeast Asian region and in South America has, in the past, caused grave socio-economic consequences. Researchers consider that, as a flow-on from the 1997-98 Asian crises, there was a 10-20 percent drop in gross domestic product (GDP) for Thailand, Indonesia, Korea and Malaysia. Of significant measure was the economic cost of the Asian crisis (the largest capital crisis in history) conservatively estimated to have cut *global* output by US\$2 trillion in 1998-2000, or fully 6 percent of global GDP (Wade 1998).

More than 50 million people (who were otherwise participants in a growing economy) fell below the poverty line. Researchers estimate officially 10 million people were left without any employment. Furthermore, the Asian crisis spread to Russia where not only has there been a forty to fifty percent drop in real incomes but most citizens’ incomes fell under the minimum cost of living. Tens of millions of Russians have been disenfranchised by the currency crises and the subsequent virtual collapse of the economy (Patomaki 2001). Whilst the economies in Southeast Asia have resurged the Russian experience has been altogether different.

One consistent theme was evident from these recent events in Asia, Russia and South America. This theme has been recorded as a prolonged decline in employment levels, the collapse of large and small business, the destabilisation of interest rates, a decline in the funding of public health systems, a decline in funding of education facilitation, and increased social, economic and cultural interference from rescuing bodies such as the World Bank and the International Monetary Fund. The Asian economies have recently become powerful again. In fact so much has the region clawed back over the past three years (2002 and 2005), that many nation-states are lending to the United States to prop up their economy and in particular the US deficit. So much has the circumstances changed in the region that predictions have been made that the Asian Region will be the powerhouse of global growth over the next three decades.

Concurrently, the severity of the crises in the 1990s has attracted rescue aid and bailout, financial lending arrangements by the World Bank and the International Monetary Fund. An example of the new regimes of borrowings from the IMF, was the creation of the Supplementary Reserve Facility in the wake of the 1997 -98 Asian financial crises. By July 1998 the international community had committed US\$118 billion to bailout programs of which \$36 billion came directly from the IMF, \$27 billion from various multilateral organisations and \$55 billion from bilateral facilities (IMF 1998a).

Capital dealers such as investment corporations and banks have made massive profits from currency transactions, and subsequent economic instability. Small margins on rapid transactions involving huge monetary stakes are played against fluctuating currency levels. Banks in Australia for instance make over half of their profits from legal 'front/gaming room' transactions taking place twenty four hours a day, three hundred and sixty five days a year (ABC 7:30 Report Broadcast: 24/03/2004, <http://www.abc.net.au/7.30/content/2004/s1073040.htm>). Huge profits are derived from transactions before and after currency collapses, or from wild fluctuations under pressure from buying and selling regimes. Profits are made from volatility and wild swings in the markets.

Patomaki (2001) cites the dealing of the HSBC (the second largest transnational bank in the world, with substantial interests and influence in Hong Kong/Shanghai/ UK, and which made US\$1 billion from foreign exchange dealings during the Asian crisis) who reported in its 1998 Annual Report that, "Dealing profits increased in 1998 as the Asian currency turmoil continued... and wide margins and high volumes in customer driven business continued to underpin foreign currency reserves (HSBC 1998).".

Only the belated intervention by the International Monetary Fund saved Thailand from outright bankruptcy. The condemnation from regional leaders including Malaysia's Dr. Mahathir Mohamed and President Suharto of Indonesia was intense and formative. Both leaders attempted to deflect blame for the cronyism that had become a defining issue of criticism in the economic affairs of both countries. Distrust of governments in the United States and Great Britain was severe and lasting. During, and in the months after the economic regional meltdown, people raged and protested in the streets and burnt down stores and shops with western

connections. They saw the social disruption as directly caused by the United States. Evidence suggests that powerful money market players in London and Manhattan orchestrated the financial collapse in the South East Asian region and created an environment of unease in the months before they jointly contrived to suddenly withdraw capital to bring the region to its knees. Anecdotal information suggested that the Southeast Asian meltdown was a premeditated response by global financial speculators to withdraw capital when the regional markets they had so heavily invested in became increasingly shaky and firms were running out of cash.

In comparison to the commercial profits from emanating from capital markets it is interesting to note that in the late 1990s and through to the early 2000s more than eighty global nation states have reported lower per capita incomes than a decade or more ago. At least fifty-five nation states had consistently declining per capita incomes. All indicative reports single out the massive growth in speculative financial markets as contributing to this unprecedented modelling as capital once used for internal restructuring and capital programs is siphoned off to global speculative markets (The International Monetary Fund 1999, United Nations Development Program 1999). There are a small number of major corporations and capital traders doing exceedingly well but it would appear that for the average citizen things are hard and getting harder in the countries where trades are conducted particularly as services are transferred from public to private ownership...

CHAPTER SUMMARY

This chapter provided an overview of global financial markets. It set out a detailed portrayal of how states interact with the global financial structure, identified the main players, and described the size of the market, risks, and present circumstances. The central conclusion of this chapter is that global financial markets are extremely large, extremely volatile, and—when they implode—have very serious economic, political and social consequences. The next chapter looks at theoretical approaches to financial markets and agency in the global financial systems. It stresses the urgent need for policy mechanisms and re-regulation.

3. THEORIES OF GLOBAL FINANCIAL MARKET REGULATION

INTRODUCTION

As detailed in Chapter 2, the convergence of private actors and global capital, acting alongside ratings agencies and powerful market players, has altered the notion of public interest in domestic, financial markets. These markets are now more concentrated and integrated than ever before. As Pauly (1997:2) notes:

The distemper of any particular age has many sources. An underlying source of our own uneasiness surely lies in the palpably heightening tension between international integration and the practical possibilities of national politics. That tension poses an ever more obvious challenge to the very legitimacy of our contemporary political

This chapter looks at the tensions between the state and global financial markets and at how the interests of financial players interact and relate to the state. The relationship is examined in the context of the considerable changes that have occurred in global financial markets during three decades of deregulation. The purpose of the chapter is to provide an overview of approaches by leading exponents in the field of political economy and state/financial market relationships (such as Strange, Underhill, Quiggin, Helleiner and Underhill and Zhang) and to use these approaches to argue in favour of re-regulation via a currency transaction tax.

THEORETICAL APPROACHES

Susan Strange (1996:44) was concerned with the linkages between the state and international capital markets and became a leading figure in theorizing the link between states and markets within her study of global political economy. She wrote about the way political economy encompassed theories about international, domestic, local and state finance, business and industry and argued in favour of the link between power in international relationships and the global monetary system. Strange argued that there is a “strong structure” in the global financial system; and that these structures constituted a set of power relations, underpinned by the international system of states.

Strange suggested that these underlying relations between states and the global financial markets affected the roles of state and non-state actors (Underhill 2000). She further argued, “the paradox is that this has not happened by accident, that the shift from state authority, to market authority, has been in large part the result of state policies” (Strange 1996:44). Political decisions have driven the changes in the economic deregulation dynamics of the state. Sometimes the political decisions are passive in terms of taking no actions in respect to the influence of financial markets.

The development of global financial markets and actors in the period between 1980 and 2005 supports Strange’s view. These developments have allowed, in particular, financial capital to play an integral role in the globalisation of production and the relocation of work opportunities. These roles constantly change as is witnessed in the production capacities of China, India and Japan. Corporations have taken on far greater powers and operate largely, in so far as their finances are concerned, outside government taxation jurisdiction.

Major US corporations now manage production in China and their money in offshore tax havens. The modern corporation will carry out dual operations within sovereign borders, transacting business within the state and then repatriating profits outside the state’s jurisdiction. This is particularly evident in the massive redistribution of funds in the United States, where corporations are taxed lower than at any time in history and the burden to fulfil state tax revenue requirements, to finance wars and other activities, is firmly placed on wage earners and small business. Lower corporate taxes are forced on governments to enable them to compete with tax havens. The United States under the neoliberalist regimes has led the financial market structural changes that are now, in large part, mirrored globally.

Strange (2000) argues that this association of state and non-state actors has led to an erosion of state power in the global system and that the reaches “of the state are retreating in the face of the advancing tide of the market, like some atoll facing submersion in the face of global warming” (Strange 2000:12). She further asserts that states, and in particular state policy (or no policies and non-decisions), have conferred powers on non-state actors, financial market players and all forms of private capital networks related to, and forming integral parts of, international

markets. She determines that these developments represent a “retreat of the state” and that “the states have been full participants in the processes” (Strange 1994 14 - 16).

Critical commentaries supporting Strange’s theory relate to the Bush Administration’s relations with corporations who have lower tax obligations and more borrowing and hedging opportunities than ever before, and which then forward profits electronically to offshore tax havens. The removal of barriers to capital flows has been responsible in the United States for increased business investment in the production powerhouse of China. Many US businesses have ‘closed their doors’ and ceased operations in America as they cannot compete on their home soil against increasingly competitive Chinese imports.

Whilst it could be argued that the state has become a willing participant in the evolving patterns of globalisation (deregulated markets, labour reforms, deregulated banking and financial services), there are forces acting in the opposite direction. While capital markets have never been so powerful, tensions between one state and another are also heightened, for example, by competition between manufacturers in China and workers in the United States. China has become the powerhouse of consumer production generating a backlash elsewhere, particularly in the United States.

In contrast to Strange and Underhill, Quiggin (2003) posits the view that the removal of state controls was enabled by policy settings designed to create a favourable climate for capital. Policy settings represent and support, in this instance, the central theme of neo-classical economics that unregulated markets, including capital markets, are self-stabilising and self-correcting at least in the long run. The assumption of promoters of unregulated capital markets is that competitive markets force governments to face the consequences of their policy actions. Hence for Quiggin,

The fundamental question is whether the world economy will be controlled by the individual and collective actions of governments, as it was in the 19th century. Framed in this way, the debate over globalisation is simply an extension, to the international stage, of the debate between the defenders of the social democratic welfare state associated with John Maynard Keynes and the advocates of free markets. Indeed, the arguments for and against allowing free movement of international capital are much the same as those for and against the deregulation of domestic markets (Quiggin 2003:2).

State policy settings have assisted financial actors (including hedge funds, derivative traders, institutional investors, and high wealth individuals) to take advantage of incentives offered by offshore tax avoidance bases to park and exchange capital without disclosure to the state, and without regulation on financial market trading activities. It has allowed powerful financial interests to take advantage of the considerable changes in technology to assist in rapid trading mechanisms. According to Quiggin, the growth of international financial markets is the result of policy decisions (or directly as a result of non-decisions) that has cleared obstacles to capital growth and speculative markets. Non-decisions have created a positive,furtive, global financial market much stronger and more vibrant than anything that could have been enabled by deliberate policy settings.

The regime of largely unregulated global financial markets has dominated political economy debates, if only because of the huge volume of trades and the numbers of participants. The weakened position of states in their relationship with financial interests is now seen as a major problem in integrated global policy-making. Quiggin (2003:1) argues it represents a “re-regulation” of the economies in the interests of global capital. Further strong pushes toward integrated markets are locked into the frameworks of international free trade agreements. Strong powers have been afforded to capital interests and the processes have been brought about by particular choices made by neo-liberal actors and neo-conservative governments in agreement. Public utilities and services have been offered to private actors as an integral part of this regime.

In contrast to the state versus market “tension theory” promoted by Strange, Underhill (2000:17) argues there has been no retreat of the state but rather that “state decision making was ... permeated by private interests” in a “changing balance of public and private authority within the state”. There can be little doubt that the mobility and opaque forms of capital transactions have weakened state control over domestic economies, and at the same time there is a serious and determined movement toward consolidating ‘free market’ reforms through free market reforms.

In taking up this theme of re-regulation, Underhill and Zhang (2002:11) argue in favour of financial market convergence. They note that:

The result of pressures and the associated regulatory changes has been a steady transnational integration of the global financial system and a blurring of the traditional distinctions between banking and securities markets. Equally important, the process of financial system convergence has led to the acceptance and promotion of the market oriented norms and practices that emphasise competition, national treatment of foreign firms, internationally acceptable accounting standards, and liquidity and transparency in financial markets. Once these regulatory changes have begun to affect the nature of financial systems beyond the borders of dominant states, drawing most market economies into the web of financial interdependence, there have emerged pressures on a wide range of governments to undertake similar programs of regulatory reforms. If these pressures can be sustained, one would expect national financial systems increasingly to resemble each other over time.

This convergence over time occurs within the context of the previously noted “impossible trinity”, which determines that a government cannot simultaneously pursue an independent macroeconomic policy, maintain a fixed currency exchange rate, and allow free international capital movements. Quiggin argues that the dominance of global capital and unrestricted movement over state borders has largely come as a dynamic of the retreat of the social-democratic welfare state during the three decades to the end of the twentieth century (and beyond).

In summarizing this section, I conclude that Strange, Quiggin, Underhill, and Underhill and Zhang have differing views on relationship between states versus market. Strange argues that the global financial system has distinctive power relations and these are underpinned by the states. She suggests that both state and global financial markets affect both state and non-state actors and that globalisation leads to speculative markets being responsible for 80% of the total volume of all global capital transactions between states. The volume and un-governed nature of modern capital supports her view of the state retreating in the face of capital advances.

Underhill disputes Stranges' approach and suggests that there has been effectively no retreat of the state and that state decisions in respect to financial policy is influenced in large part by "private interests". Quiggin in contrast to both Strange and Underhill posits the view that the removal of state controls on capital is enabled by deliberate policy settings to free up capital capacity on a global scale and that states are less able to make choices concerning key areas of governance and policy in the wake of a shift in power to financial markets and, further, that states were less able to defend the values that history had conferred on them (Underhill 2000:6 and Strange 1994:216). Underhill and Zhang both state that the process of financial convergence has led to acceptance of market oriented norms with the tacit support of the state.

The role of the state has been in large part to accommodate the influence of new circumstances in global capital activity partially brought about by rapid advances in information technology, communication systems, skills of financial market analysts, and the proactive nature of individuals, businesses, corporations and markets to respond to these changes. New modes of operation have been forced onto governments who are often reacting to changes which are fundamentally altering the financial landscape of their states. Hedge funds and derivative markets have the capacity to rapidly alter the positive and negative circumstances of states.

INFORMATION TECHNOLOGY

The theoretical approaches examined in the previous section identify decisions and, particularly, non-decisions by states as a driving force of financial market integration. However, such integration would not have been possible without the growth and development of the new information technology. The major instrument in the new world economic order is the efficiencies supplied through the information technology (IT) industry. Without this vehicle of super sophistication there would be little chance of transferring the volumes of capital in global speculative markets. Computer based international markets facilitate massive exchanges all day every day of the year.

The sophistication of information technology systems allows for secrecy in trading from any established base (or any laptop computer facility) in any country. There are no international borders or physical obstacles to prevent the flow of transactions. In fact the largest centres for hedge fund activities and currency transactions are designated offshore status areas, led by the City of London in the United Kingdom. These centres are also maintained by state-of-the-art IT networks that interact between, for example the City of London and the Cayman Islands. This is limited only to the time it takes for a human prompted computer system to trigger a trade. Helleiner (1998:1) suggests that:

The challenges to state power and control in the financial sector have led some analysts to suggest that the IT revolution is causing a profound transformation in the nature of the world order. A dramatic relocation of power and authority is seen to be taking place in global politics, involving the decline of the sovereign state.

Advances in the IT industry between 1998 and the present have been enormous (as has the volume of capital the industry accommodates). Wriston (1986:61) and Sassen (1996:21-22) noted that in respect to the influence and mobility of global capital, the new world financial markets had no specific geographical location to be found on a map but, rather, more than two hundred thousand electronic monitors in trading rooms all over the world that are linked together. With the new technology no one is in control.

Other academics (Mackenzie, Lee and Cerny 1994) argue strongly that states are losing control over the global capital markets as they are inhibited from placing controls and regulations on traders because of the strength of the concomitant competitive neo-liberalist deregulation dynamics under which all markets are absorbed. In corporate terms it was interesting to note that the Enron building in Houston, Texas, had two complete floors of its corporate headquarters designated solely to the information technology section of its derivatives trading section. These types of corporate trading rooms are in most Australian banks and feature regularly on news programs that retail stories on currency trading scandals.

Eighty percent of all monies associated with financial globalisation are speculative capital that is used for transactions through the sophisticated IT networks (Greider 1998, Potomaki 2001, Willans 1999). In Australia there are rules and regulations concerning these trades but this is not so in the blossoming offshore financial centres that attracts an increasingly large volume from international trades. The information technology developments have grown apace with volumes of capital and expansions of tax havens.

OFFSHORE TAX HAVENS

Policy non-decisions and the sophisticated new IT technology have generated locations in the global system that permits systematic tax minimization. Most of the trades in currency transactions and the vast range of 'designer' financial instruments are undertaken outside the jurisdiction of the state. In many cases the jurisdictions have been set up specifically by states to 'capitalise' on the trades and the by-products that a massive flow of capital adds to state economies. There are also benefits to states with respect to employment opportunities and value-added products that find their way from the havens. Most of the top six leading global accountancy and audit firms operate both inside the off-shore jurisdictions and within the normal economy of the state providing similar services; promoting and attracting capital between the two entities. This is usual practice and through the complicity of state policy makers they are allowed to carry out regulated business in one region and unregulated business activities in another.

Some tax havens were operating well before the proliferation in currency trading systems and networks, and became the dominant force in global financial trades. The Isle of Man and Jersey, for example, have operated with benefits and attractions for capital investments and tax minimisation for decades. Others have proliferated during and after the deregulation of global banking and financial markets throughout the eighties, nineties and early in the 21st century. Gibraltar, Liechtenstein, Belize, Costa Rica, Vanuatu, British Virgin Islands and Mauritius operate financially vibrant economies that cater almost exclusively to currency and financial traders who see their roles as not being subservient to the laws and policy settings of states.

In 2004 OXFAM reported that developing countries alone were losing over US\$50 billion a year to tax havens, which was the equivalent to over half of the total aid budgets directed from developed countries. Tax havens remain an enigma in global capital markets. Only 1.2% of the world's more wealthy people are domiciled in the havens, which hold over 26 percent of the global financial assets and store 30 percent of US corporate profits (ABC Radio National 25/3/2004). *The Guardian* reported in September 2001 (www.uniset.ca/microstates/g_taxhavens.htm) that offshore companies were being formed at a rate of about 150,000 a year. Tax avoidance in Britain is estimated to be between 25 and 85 billion pounds sterling a year. The unregulated nature of the market is the reason for such a vast range in the estimates. No one really knows.

Tax havens are unique and growing. The OECD calls havens such as the Bahamas, Cook Islands, British Virgin Islands, Monaco and others, the “dark side of globalisation” (OECD 2003). Corporations say that the use of tax havens allows them to maximise profits and remain competitive in global markets and provide maximum returns for shareholders. Australia's major telecommunications giant, Telstra, used this argument of maximising shareholders profits when it announced that it would set up a joint venture in the prominent tax haven of Bermuda. Telstra argued that setting up in Bermuda allowed extensive access to international capital which flowed through Bermuda and that the tax minimisation aspect of the move “was the secondary consideration” (ABC Radio National 25/3/04).

Close to Australia is Nauru in the South Pacific. Nauru is a new offshore financial centre with a population of 10,000 people and 400 banks. In comparison there are 570 banks in the Cayman Islands. Tax havens or offshore financial centres promote their tax-free status openly as they canvas on the internet to attract new investors. An example of the open nature of enticement offered to havens (that must concern policy makers worldwide) is a group called www.a861.com. Offshore who suggests that:

Offshore tax free investments and protection strategies can save ordinary investors hundreds of thousands of dollars a year. Not to mention access to more aggressive investments. You can now “OPT OUT” of your high tax over regulated financial system easily using today’s offshore alternatives (digital currencies, investments and debits) to your business offshore with anonymous web-hosting and domain name registration free income onshore – spend it tax free onshore (www.a861.com:Offshore)

The www.a861.com.Offshore website encourages investors to access the domain sites offering Anonymous E-Gold, Anonymous Offshore Debit Cards, Offshore banks and Offshore Hosting and Domains. There are hundreds of sites competing for corporate and individual investment capital worldwide in an unparalleled selling and marketing deployment that is causing belated concern in many developed and undeveloped countries. Australian Tax Office Commissioner Michael Carmody said that about 95% of tax haven users were big business and rich people (Wade 2003).

In the 2003 financial year over A\$5 billion dollars flowed out of Australia to 41 identified tax havens, including Bermuda, Jersey, and the Cayman Islands. This amount is considered to be a conservative estimate. Sophisticated IT allows secretive transfers. Worldwide, the amount estimated to be diverted from state economies to tax havens is over US\$5 trillion a year. Australia’s financial intelligence watchdog, Austrac, has said that every four seconds transactions are recorded of money leaving the country, but Austrac’s CEO, Paul Ryan, admits that the new technologies and digital networks make it impossible to accurately assess all transactions. Austrac has seconded John Walker, whose groundbreaking work on money laundering is used worldwide, to head an investigative team. Mr. Walker said that, “Globalisation has created opportunities for large scale offenders (*The Age*, January 10 2004). It has also created significant problems in the relationship between states and markets.

High profile investors, including the late Rene Rivkin, highlighted the offshore account issue. It has been alleged that Mr. Rivkin, former Australian Labor Party heavyweight Graham Richardson, and former Qantas CEO Trevor Kennedy used Swiss bank accounts to hide funds derived from the burning of industrial premises in Queensland. These allegations are currently under investigation but serve as a demonstration of how funds may be transferred and hidden from investigation (apparently with ease). An enormous amount of offshore accounts were also legally set-up during the banking and financial industries deregulation (and the effective lifting of capital controls) between 1983 and 1990 in Australia.

The late Yasser Arafat's vast fortune is hidden in secret accounts in tax havens around the world. Robert Mugabe is a heavy user of tax havens. Little is known of the amounts that have been accumulated during his long reign (*The Weekend Australian*, December 13 2004). Eli Szewach, CEO of casino technology corporation Regis Controls, suggests financiers and investors, including banks, have been 'running rings around' government regulations and attempts to thwart rivers of money travelling to offshore accounts. The Australian Tax Office (ATO) has recently introduced new measures designed to address the problem. The lack of accountability and fraudulent networks are so sophisticated and entrenched that it is hard to project the success of these new measures, as has recently been demonstrated by the "Gerard Tax Avoidance Affair" in Australia..

In a belated reaction to money laundering and lack of control by the state the ATO will have special powers through treaty negotiations with tax havens in Guernsey, Antigua, Barbuda, Bermuda and the Isle of Man to analyse transactions. ATO Investigators will audit 1450 individuals earning "overseas incomes" and Michael Carmody, Australia's Tax Commissioner, says "our profiling has identified at least 700 agents who we will contact to discuss the result (of investigations)". In 2003 the ATO recovered \$A6.4 billion that had been illegally invested in tax havens outside Australia (Dickens, August 29 2004). International efforts in surveillance of the sophisticated offshore networks have been stepped up at considerable cost to the state. Tax paying citizens of the state effectively fund surveillance exercises to track the offshore tax avoidance of wealthy individuals and firms.

Australia has entered into an agreement with the United States, Canada and Great Britain to combat tax avoidance by corporations and wealthy citizens. In a pro-active but little publicised move the Howard Government has rubber stamped new aggressive internal and external joint approaches to address this major issue that is sapping the country of billions of dollars. Australian government officials met with their counterparts in Virginia, USA, and agreed to jointly fund a task force of special agents to be based in New York. This task force will be given special powers to investigate tax avoidance, particularly in tax havens. It is envisaged that the four-nation pact will soon include other states. Major revenues from speculative currency transaction deals end up in the tax havens and these will be a prime task force focus (Big News Network, April 25 2004). Policy makers must take these steps to arrest the drain of funds from the state.

AGENCY IN THE GLOBAL FINANCIAL SYSTEM

Policy non-decisions, technology and tax havens create a structure within which a variety of actors can operate to generate significant profits. In addition to the dealers, brokers, banks, corporations, pension fund managers and individuals outlined in Chapter 2 that “play” the global financial markets, there are other intermediaries — notably the accountancy firms that assist corporations and wealthy individuals to hide their money overseas and the financial lobbyists that promote further deregulation. Accountancy firms like KPMG and Ernst and Young enjoy the benefits of attracting clients in regulated states (such as the United States and Australia) to invest in tax minimising schemes based in offshore centres. It has become a central part of the business of these firms and advertised widely on the internet. Whereas not so long ago hedge funds and offshore haven were the domain of the rich, a change in strategies has lured small and medium speculators to embrace enticing offers.

The SBS television program *Tax Me If You Can* (Frontline June 2004) made an investigative case study of a corporate manager in Florida who received a large amount of capital as proceeds from the sale of a business he managed. In a secretive assignment, SBS followed his introduction to KPMG and the path to tax haven culture, which repositioned the funds from mainland United States to the Cayman Islands. The Frontline documentary profiled the secrecy at all levels of the operation. The funds were deposited in a banking/investment house in the Caymans and the

manager of the operation suggested that there was nothing abnormal or out of the ordinary in the way the funds were being “looked after”. This is an example of the gulf that exists between states and global market operations. It is an example of the way corporations outmanoeuvre the state at every turn. States have passively and implicitly encouraged the allure of havens.

Hedge fund investment is massive and currency and derivative trades set new volume records throughout the first four years of the new century. Global derivatives trading grew by 29% in 2004 alone (Derivatives Study Centre 2004:3). An increasing share of international financial transactions is dominated by a small number of institutions from a small number of countries who have the geographical networks, specialist knowledge and technical expertise to command market power. The top 15 global firms have increased their market share from 31 per cent in 1990 to 75 per cent of the derivatives market in 2000 (Kremm 2005:6). Uninhibited leverage positions with ratios over 1 to 50 are commonplace in a desperate race to achieve returns on investments.

Behind the accounting firms promoting sophisticated financial packages, including hedge funds, lie the financial market lobbyists. The lobbyists influence on policymakers is well documented (Heilleiner 1998:12). Heilleiner argued that the changing dynamics of capital markets was sealed with the failure of the US Federal Reserve to dictate the US regulatory environment for three reasons. First, it demonstrated that financial institutions could now arbitrage between national regulatory systems and choose the one most conducive to their business aims. Second, the establishment of international banking facilities (IBF's) free from tax and domestic regulatory restrictions led directly to competitive deregulation in states as competing hosts to new markets. Third, the failure of a conservative approach to bank regulation and macro-economic management heralded the development of neo-liberal financial regulation (Kremm 2005:7).

Whilst there are alternatives such as currency transaction taxes and capital controls, policymakers must contend with propaganda and lobbyist pressures of these powerful capital market players who ignore or dismiss regulatory issues and cite market freedom as their primary cause. It is too late to re-regulate or try to change governance of the financial markets. They have grown powerful by themselves. They have engineered the architecture that has reached very high states of efficiency and competence with the evolution of technology, and also generate much of the political propaganda in favour of further financial liberalisation, as detailed in the next section.

POLITICAL PROPAGANDA

The propaganda generated by media controllers such as Murdoch, Packer and others extols the virtues of people paying ‘their way in society’ whilst these same individuals hide their corporate investments through offshore trusts which minimise their tax rate. The Australian public are subjected to an endless array of prime time television programs exposing ‘dole-cheats and tax bludgers’ whilst the station owners reap the serious ‘big-end rewards’ provided by conservative media license arrangements. News Corporation (Murdoch news media company) has hardly paid any taxes in the UK since 1988, which is not a coincidence given that the UK has so many tax havens that are crown dependencies (*The Guardian*, April 12 2004).

In the United Kingdom, *The Guardian* investigated 101 Murdoch subsidiaries, and estimated lost revenue (through legal tax dodging) to be 350 million Pounds Sterling, enough to build seven hospitals, 50 secondary schools and 300 primary schools (Cohen 2002). It is the loss to states internal revenue that is the major issue. This internal revenue loss from money earned within sovereign states (and subsequently expropriated) was estimated (in 2002) to be US\$70 billion a year in America and 85 billion Pounds in the UK (Sikka 2002). Tax havens, offshore investments, tax minimisation schemes, and hidden revenues provide the cause and effect of major state/financial market tensions and misalignments in public policy.

Globally it is estimated that one-third of the world's worth (over US\$6 trillion) is now held offshore and it is suggested that at least a quarter is laundered money (Cohen 2002). State leaders are aware of the serious problems posed by the continuing ease with which tax havens and foreign currency speculators place their business and capital outside the reach of state control. There is a growing emphasis for all currency transactions to centralise transaction transparency with the Bank for International Settlements (BIS) and for the OECD to force tax havens to at least register the nature of their operations. Neither of these attempts at regulation appears to offer effective controls other than a cosmetic approach to rein in an economic juggernaut. Propaganda by capital interests stalls these processes. State policy-makers are averse to making policy that is not aligned to ratings agency models and guidelines.

THE NEED FOR RE-REGULATION

The notion of market distortions giving rise to instability in the foreign exchange markets was first described by Keynes (1936), who suggested that asymmetric information and resultant herd behaviour on the part of investors contributed greatly to the vulnerability that could be perceived in all foreign capital exchange. This led to the assumption "that incompletely informed investors' display successively, excessive optimism and excessive pessimism when balancing risk and capital investment" (Keynes 1936). Investors tend to follow the lead of other investors in committing funds to fashionable emerging markets. Keynes (1936), Friedman (1953) and Tobin (1978) concurred on this point. Each looked at mechanisms that could be put in place to control foreign exchange capital on their outward and inward journeys. They recognised the danger of uncontrolled outflows. Recently, such views have been supported by political and economic commentators such as Eichengren and Wyplosz (1996). They argue that as investors follow the lead of other investors to fashionable emerging markets, then similarly, an unprovoked reaction to 'loss of sentiment' will lead to a flight of capital virtually instantaneously from a host state. They suggest that in the event of this scenario "everything that was gold turns to dross overnight".

This chapter provides a case for market re-regulation. It concludes that there has been a significant loss of state authority over speculative global financial markets. Through an examination of economic market theories there is clear evidence that most noted commentators (Strange, Underhill, Zhang and Quiggin) all concede differing theories of state versus market but agree that the rising power of capital markets is causing considerable stress to states. The markets are assisted by the growth and development of information technology, secretive offshore tax havens, international accountancy firms, and an increase in political propaganda generated primarily from the neo-conservative political factions in the United States. This chapter concludes that severe economic and social risks are imminent if re-regulation of capital markets is not taken seriously by states.

In recognition of these problems, measures have been proposed to re-regulate capital markets. One well-publicised proposal, and perhaps the most serious in respect to the growing debate, is for a currency transaction tax (CTT), originally proposed by James Tobin and later developed into a two-tiered model by Paul Bernd Spahn. Rodney Schmidt (formerly an economic advisor with the Canadian Government and now with the North South Institute and based in Hanoi, Vietnam), has been a champion of a tax on foreign currency transactions, as has respected economic commentator Barry Eichengreen. These models all aim to place a small tax on currency transactions to regulate and discipline the markets. It is the central argument of this thesis that a CTT is both economically and politically feasible as a means of regulating global capital markets, and the following two chapters explore, in turn, its technical and political feasibility.

4. CURRENCY TRANSACTION TAXES: ECONOMIC FEASIBILITY

INTRODUCTION

The deregulation of financial markets has led to a theoretical consensus on their transformative nature. For many theorists, financial markets appear to be an unstoppable juggernaut, sweeping domestic regulation before them. Some, however, note that states remain in charge through their decisions and non-decisions and that there are a number of regulatory options, including the implementation of a currency transaction tax. Before examining the political feasibility of a CTT, we need to know more about what a CTT is how it operates, and the different models that exist. The purpose of this chapter is to outline three different models of currency transaction taxes—by Tobin, Spahn and Schmidt respectively. A close study of these models demonstrates the technical feasibility of regulating financial markets via a small tax on currency transactions.

JAMES TOBIN

In the ground breaking, best selling exposé of contemporary American political economy, author Paul Krugmans' (2003) book "The Great Unravelling: from boom to bust in three scandalous years" examines the failures of the American capitalist system over the years 2000–2002 and concludes that under the stewardship of George W. Bush there has been a steady decline in confidence, financial management abilities and corporate accountability to the point that all the positives inherited by Bush have been turned into morale-sapping losses on the domestic and corporate fronts.

Confidence in the economy of the United States has fallen away during Bush's stewardship and has continued after his re-election. Confidence in appropriate levels of corporate responsibility has evaporated and the poor handling of domestic politics has left the United States economy in a state of distress. Krugman completes his strong attack on the current Bush Administration by stating that the decline of confidence in America reached one of its lowest points when James Tobin passed away on March 11 2002.

Krugman suggests that the passing of Tobin, who was regarded in the United States as one of the most gifted, inspirational and influential economists of his time, was more than just a coincidence when comparisons are made with the decline in confidence in American political and economic circumstance (Krugman 2003). Krugman urges readers to look back at the decades of economic growth in the United States and Europe as a period of time when strong leadership and sound growth patterns were interrelated with the intellectual ability of persons such as Tobin. A press release by Yale University at the time of Tobin's death stated that he

...possessed a rare clarity of mind and a deep moral sensibility. We who had the privilege to study with him would all agree that he was our greatest teacher (http://cowles.econ.yale.edu/archive/people/tobin/tobin_ynm).

Professor James Tobin had a long and distinguished career as a leading economist who graduated with a PhD from Yale in 1947. Tobin's teaching career, principally with Yale University, spanned over fifty years. He centred his study and teaching on how economic policies changed and affected people's lives and to that end he believed that governments and policymakers could use fiscal and monetary policy to change and benefit society. Tobin's earlier research provided theoretical underpinnings for Keynesian macroeconomics theory and led to the modern theory of portfolio choice and asset pricing.

In the 1960s Tobin won a place on President John F. Kennedy's Council of Economic Advisors. Thinking perhaps that he might not be suitable to Democratic politics, Tobin suggested to Kennedy that he was "an ivory tower economist" to which Kennedy reassuringly replied, "I am an ivory tower president". One report, that Tobin and other council members Kermit Gordon and Walter Heller wrote together on the Council, was "a seminal statement of political and economic policy" that was to dominate public discourse for many decades.

In 1981 Tobin received the Nobel Memorial Prize for Economic Science for what the Royal Swedish Academy of Science cited as his "creative and extensive work on the analysis of financial markets and their relations to expenditure decisions, employment, production and prices" (Cowles 2002).

Tobin's work on the taxation of foreign currency transactions became famous in economic and political discourse, as it was the first measured response to what Tobin suggested in his 1972 article as a tax aimed at stabilizing exchange rates and reducing global financial speculation. The use of money derived as a result of the global tax impost was not the main driver of Tobin's proposals. Contemporary discourse on currency transaction taxes (CTT) predominantly focuses on technical issues associated with models provided by Tobin and Spahn. Friedman argues that problems in foreign exchange markets are attributable to inconsistent domestic policies whereas Tobin, like Keynes before him, attributes instability to financial market distortions caused by asymmetric information and the herd behaviour of investors (Eichengreen and Wyplosz 1996:19). This theme is picked up by Edmond Warner writing in *The Guardian* (May 14 2005) in an analysis of current hedge fund problems:

The herding instincts of investors are truly remarkable. Similar beasts stick together, chasing the same stocks at the same time and often risking great financial peril, but such instincts can also overwhelm very different investor species. In recent times the grandest of hedge fund managers have found themselves shoulder to shoulder with the scruffiest day traders...toward oblivion.

THE TOBIN TAX

Tobin first introduced his taxation proposal in his 1972 Janeway Lectures at Princeton University. Tobin called for a levy on international currency transactions to make the system accountable in times of capital flight. The original proposal was not greeted with enthusiasm because this was predominantly a period for optimism and confidence in the post-Bretton Woods era of floating exchange rates, and trading volumes were comparatively modest.

Although the proposals were subject to limited debate, it would seem that three major developments created an upsurge in interest. The first has been major economic and social dislocations following currency crises over the past three decades. Secondly, there has been an unprecedented rise in the volumes of speculative capital on trading markets and the trend toward investing public monies in hedging and trading instruments. The third major development is the pressing need for states to fund reconstruction projects following the devastating North

African famine and social displacement in Darfur, the economic and social havoc after the Asian Tsunami and America's new "war" on terrorism.

A Tobin tax, which has several percentage models, would discourage short-term capital runs through an impost designed to make transactions of less than a week in duration (86% of all speculative transactions) less economically profitable. In addition, it would generate significant fiscal income for host states as set out in Table 4.1.

Table 4.1: Annual Revenue (US Dollars) from a Tobin tax by collecting country (2001 foreign exchange volume at US\$1.5 trillion per day)

	Tax rate			
	0.10%	0.05% and percentage	0.025	
Industrial Countries	<u>\$billions</u>	<u>\$billions</u>	<u>\$billions</u>	<u>\$billions</u>
United Kingdom	89.0	43.7	(29.5)	26.6
United States	46.8	23.0	(15.5)	14.0
Japan	30.8	15.1	(10.2)	9.2
Switzerland	16.4	8.0	(5.4)	4.9
Germany	14.4	7.0	(4.7)	4.2
France	11.3	5.5	(3.7)	3.3
Australia	7.4	3.6	(2.4)	2.2
Denmark	5.7	2.9	(2.0)	1.7
Canada	5.5	2.6	(1.8)	1.6
Netherlands	4.7	2.2	(1.5)	1.3
Sweden	3.6	1.8	(1.2)	1.1
Other OECD	25.1	12.3	(8.3)	7.6
Group total	260.7	127.7	(86.2)	77.7
Developing Countries				
Singapore	20.0	9.8	(6.6)	5.9
Hong Kong	17.1	8.4	(5.7)	5.1
South Africa	0.9	0.4	(0.3)	0.3
Bahrain	0.5	0.2	(0.1)	0.1
Other LDCs	2.9	1.7	(1.1)	1.0
Group total	41.4	20.5	(13.8)	12.4
Global totals	302.1	148.1	(100.0)	90.1

Notes: Figures in parentheses are percentage of total. Source: CLS
www.cls-group.com/faq/faqQuestion.cfm?questionID=839D3AB3-64C9-49FC-8.

It should be noted that in the case of Australia, whose 2001 trading volume was the seventh largest in the global financial community, the three models indicate annual revenue ranging from a high of \$7.4 to a low of \$2.2 billion. Most Australian banks and finance houses have been a part of the phenomenal growth in speculative activities, particularly over the three years to 2005. Figures for 2005 would be at least 25% higher than those of 2001. Evidently, these are significant sums.

Tobin's original currency tax proposal was for a 0.25% tax rate to discourage "short run" speculation, which refers to capital transfers and transaction of less than one week in duration. Such an impost would minimise shocks arising from major currency movements. The proposal was designed to give states a regulation policy to enhance the ability to control financial volatility and to provide autonomy in monetary policy. The 0.25% rate would effectively discourage larger scale withdrawal patterns by incurring a tax on every cross-border transaction, whilst not having more than a marginal effect on longer-term more stable capital investment patterns. An illustration of how the Tobin Tax would work using European settings as an example is set out in Figure 4.1.

This is how Tobin described his tax in an interview with the German magazine *Der Spiegel*, reproduced in *Le Monde* (September 2001):

This tax aimed to limit exchange rate fluctuations. The idea is simple: On each operation, a minimum levy is made equivalent to, say, 0.5 per cent of the transaction. Enough to put off speculators. For many investors place their money for very short periods in currencies. If this money is suddenly withdrawn from the market, countries have to raise their interest rates considerably so that their currencies remain attractive. But high interest rates are often catastrophic for the internal economy, as the crises which hit Mexico, South-East Asia and Russia in the 1990s show. The Tobin tax would give back some margin for manoeuvre to the central banks of small countries to fight against the tyranny of financial markets.

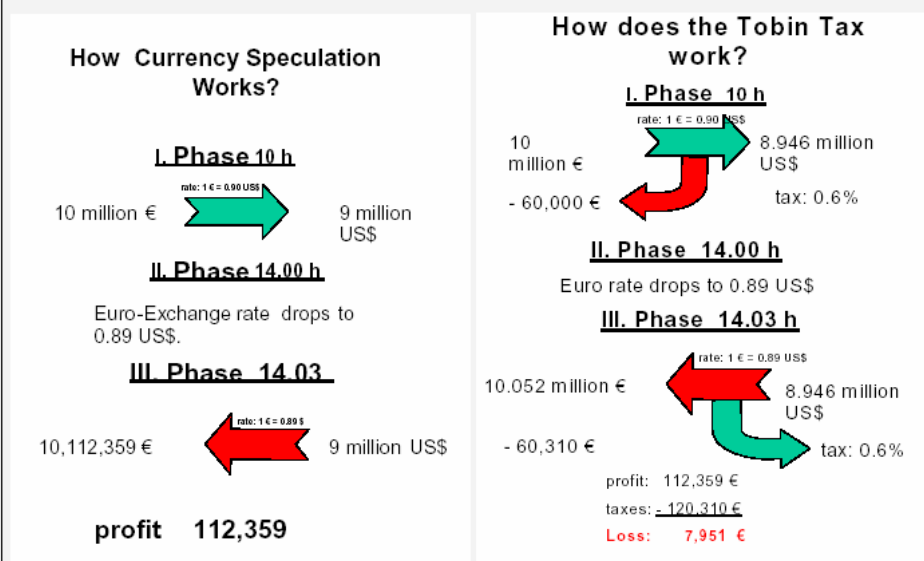
Figure 4.1: How the Tobin Tax Works**Box 4: How the Tobin Tax works**

A case study shows the practice of foreign exchange speculation and the effect of the Tobin Tax. The normal procedure of such a speculative transaction is carried out like the following scheme:

Phase I, 10.00 am.: Anticipating that the Euro will fall in relation to the Dollar by one Cent in the afternoon, I exchange 10 Million Euro for Dollars in the morning. The rate of Euro to Dollar is currently at 1:0.90. Therefore, I receive 9 Million Dollars for my 10 Million Euros.

Phase II, 2.00 pm.: The rate of the Euro declines in the afternoon as expected, by one Cent, i.e. the rate of Euro to Dollar is at 1:0.89.

Phase III, 2.03 pm.: I change my 9 Million Dollars that I received in the morning back to Euro. With the new exchange rate, I receive 10,112,359.55 Euro. So I have made a profit of 112,359.55 Euro. This is the gross amount of course, since some small fees and other costs are deducted.

Fig. 3: How the Tobin Tax Fights Currency Speculation

Source: Peter Wahl, WEED

If a tax was imposed on every foreign exchange transaction, then the transaction would look like this:

Phase I, 10.00 am.: I exchange my 10 Million Euros to Dollar in the morning. Rate 1:0.90. However, there is a tax imposed now. To explain the logic we will set the tax rate at 0.6% to simplify calculations. This means I pay a Tobin Tax of 60,000 Euro.

Phase II, 2.00 pm.: The rate of the Euro again falls by one Cent in the afternoon.

Phase III, 2.03 pm.: I exchange my 8.946 Million Dollars back again. However, this transaction also entails a tax of 0.6%. At the new afternoon rate of 1:0.89 this means 60,310 Euro. If I compare my profit with the taxes of 120,674 Euro, I find out that I have made a loss of 7,951 Euro. Since an institutional investor has already made this calculation in advance, there will be no transaction.

(Peter Wahl May 2005)

Tobin was informed in his approach for such a tax from the work of Keynes who had suggested a national tax on internal financial speculation as one of his reforms to get out of the devastating grip of Great Depression of the 1930s. The idea was to encourage money-capital to be invested productively instead of being used for unproductive speculation. Although Tobin was awarded the Nobel Prize for Economics in 1981, no government seriously looked at his proposal until the mid - 1990s when financial crises caused social dislocations and governments were forced to step in with rescue packages. This was because the Tobin tax, in order to work, required the consent and involvement of participating capital trading states, one of the reasons Tobin recommended that it should be overseen by the World Bank or the IMF.

Tobin noted that many other international financial investment transactions were attracting ad hoc taxation measures of one sort or another. He suggested that the absence of “spot” transaction taxes would render his proposal an acceptable option because it would not interfere with genuine foreign exchange transactions, whilst providing states with a regulatory control mechanism on all forms capital movements. He argued for fully inclusive models.

In his 1978 presidential address to the Eastern Economic Association conference Tobin (1978) said:

Governments are not and cannot be indifferent to the changes in the values of their currencies in exchange markets, any more than they did or could ignore changes in their international reserves under the fixed parity regime. The reasons for their concern are not all macroeconomic; they include all the impacts on domestic industries and export and import competing sectors that arise from exchange rate fluctuations originating in financial and capital market transactions. The uncoordinated interventions that make floating dirty are governments natural mechanisms of defence against shocks transmitted to their economies by foreign exchange markets.

Interest in Tobin’s proposals continues in Europe, Canada, South America and beyond. In November 2001 Jorg Hufschmid, an economist attached to the University of Bremen published a paper outlining his support for a Tobin tax to be implemented in Europe alone. Hufschmid opened his appraisal of the concept by suggesting:

The following text is not dedicated to the question (of) whether or not the Tobin tax (TT) is generally desirable or technically possible, since the former issue is widely acknowledged in political circles, and the latter not doubted anymore, in particular by bankers. The crucial argument against the TT—which possibly serves as an alibi to enable one to refuse the concept flatly even though such a refusal is not opportune anymore politically—is that it is supposed to work only if all major financial centres in the world participate.

Huffschnid provides a technical evaluation, which centres on the crucial issue that by implementing a stand-alone European currency transaction tax, traders would circumvent the system by at least partially bypassing the regulated market in favour of the unregulated one, possibly operating from a tax haven. It is possible to operate the system of regulating a CTT (a view which has been openly debated by critics of tax proposals) within the European theatre by basing the system on the standard pricing, or broking procedures. This system is used in the electronic inter-bank market system and accounts for 85-90% of all transactions. It is possible to implement an additional procedure, which in every step of the transaction sends a message to a tax revenue authority (Bank for International Settlements, Continuous Link Systems). Huffschnid argues that a European Union specific currency transaction tax is feasible within certain constraints (Bank for International Settlements, AR 71 2002: 99).

Most commentators acknowledge that the CTT proposed by Tobin would have administrative and start-up problems but that the main strategic benefits that could flow from a CTT would be:

- To reduce short-term speculative currency and capital flows;
- To enhance the policy autonomy of nation-states;
- To restore the taxation capacity of nation-states affected by the internationalisation of money markets;
- To create a positive revenue stream from financial transactions initiated in the trading zone of independent nation-states;
- To restore financial sovereignty;
- Providing a safety net mechanism to prevent short term withdrawal of critical mass capital; and
- Most importantly to provide a source of capital to fund alternative projects including, possibly, social welfare payments, Third World development, world health pandemics and global security

The tax is a simple formula for slowing destabilising flows. The main revenue base consists of an impost on short term, two-way speculative and financial transactions taxes on all inter-bank and financial trading houses. According to the nature of CTT's the higher number of short-term transactions from single traders the higher the tax impost. Likewise the trader would be disinclined to establish multiple positions on trading options because of the double and tripling of the tax. Under Tobin's model the higher the frequency of transactions, the higher the tax charges. There is one charge for each transaction. This is a modest charge to traders but overall this modest charge translates to significant overall revenues.

The CTT proposed by Tobin provides a tax impost on short-term transactions whilst it does not inhibit long-term capital flows or interfere with currency price revaluing. Unstable, fluctuating, and flexible currency exchange rates hold the key to speculative positions. The more options on betting ranges the more diverse and extended the market becomes. The options promoted by Tobin have been further refined by economists such as Paul Bernd Spahn and Rodney Schmidt and it is to these two models that I now turn.

THE SPAHN MODEL

Spahn is a Professor of Finance Theory at the University of Frankfurt. He was a Visiting Professor at a number of universities in Australia during the 1990's and has been an advisor to the IMF. In March 2002, the UN Finance for Development Conference was held in Mexico and the German Ministry for Development commissioned Spahn to write a paper for presentation at the conference. Spahn produced a study entitled "On the feasibility of a Currency Transaction Tax". In this study, Spahn concluded that a CTT made sense from an economic point of view and that its implementation was extremely desirable given the considerable blow-out in currency and other financial trades on a global basis.

Spahn argued that the implementation was technically as well as economically feasible and that a CTT would allow for stabilisation of exchange rates. Additionally he argued that for developing countries the CTT would be complemented by his two-tier model which would reduce volatility and have the effect of stopping major in-flows and out-flows of speculative capital (Wadlow and Wahl 2002; Spahn 2002). Spahn argued that the only real impediment was the lack of will among policymakers. He suggested that these impediments should be debated.

Spahn was supported in his approaches to the CTT debate at a philosophical level by two ministers and a deputy minister in the German government: the Development Minister Mrs. Heidemarie Wiecek-Zuel, the deputy Minister for Foreign Affairs Ludger Volmer, and Foreign Minister Joschka Fischer. In 2004 Fischer as the new European Foreign Minister attempted to obtain its endorsement. Other ministers in Europe remain sceptical of Spahn's proposals. The Spahn paper attracted significant debate, both inside and outside the German Parliament, and on a wider scale, following the conference.

Spahn's model is an extension on the Tobin proposals for currency transaction taxes. Spahn argued that his universal two-tiered system would provide a more acceptable lower first tier tax model. This contrasted with market suspicions that the singled tiered Tobin proposal was too flexible, with states increasing the rate to earn greater income. Spahn proposes one modest universal rate as the first tier and argued that the low, first tier tax rate would not deter currency traders.

Spahn's major departure from the Tobin proposal is the implementation of a second-tier, which imposes a surcharge at a time when speculative attacks occur and speculative capital flight proceeds. The merit in this tax is obvious and its initiation at times of highly volatile activity such as occurred in Southeast Asia, Russia and Argentina would be very beneficial. One of the greatest threats associated with currency transaction activity is the rush to the exit doors when speculators withdraw positions.

In most instances, the limited flight of capital registers only as a drop in the value of a state's currency relative to the US dollar or other currency benchmarks. In more serious cases, capital flight can be exaggerated by the "herd mentality" which can have major dislocation effects, triggering serious social and economic problems. Spahn argues that the imposition of his second tier tax (when the surcharge is effectively triggered at a given time in the volatile run and transaction costs substantially rise) would be enough to stop a stampede and allow some breathing space for rational choice.

Spahn's proposal is that the first tier would allow for smooth unimpaired market activity that would be regulated in the sense that all transactions would be registered and taxed at a low level in much the same way as a Tobin proposal. The revenue could be used for a variety of purposes including social and infrastructure services but allocations of revenues could be at the behest of the host country or financial region and could be contentious. This is a departure from the Tobin model that preferred international supervision. The high rate second tier would curb volatility. It creates a safety net model to dampen capital outflows. One persistent argument levelled at the Tobin tax proposals is also relevant to the Spahn models. That is with respect to the administrative difficulties entailed in implementing such an arrangement. The advent of the Bank for International Settlements largely negates these arguments, however (see below).

The prototype nature of Spahn tax proposals has raised criticisms from commentators who suggest that variable tax rates complicate significantly the burdens on both tax payers and tax administrators and further that they consider it inadvisable to mix monetary policy with tax policy, given the different nature of each proposal. The types of transactions to be taxed and the likelihood of nation-states ambivalence towards any proposals are a major stumbling block to the Spahn's, Tobin's and other models.

THE SPAHN TECHNICALITIES

Spahn's proposals have considerable academic appeal and this has been recognised in Europe, where his paper "On the feasibility of Currency Transaction Tax" was the subject of many favourable critical reviews. Whereas a CTT has been at the forefront of Left and Social-Democratic thinking for a decade, the Spahn paper was presented to and for a politically conservative audience. The balance and vision of the Spahn proposals has found support across broader political-economy groupings and civil society. Spahn's study in fact gives credence to the Tobin model and the first tier model is aligned to Tobin modelling. The major differences are in the nominated percentages of the models with Tobin favouring 0.25% and Spahn recommending only 0.10%. This is because it is his second tier that provides the deterrent by its application of heavy penalties when speculative capital runs need to be thwarted. This model proposes a lower initial revenue base but higher security outcomes in terms of stemming capital flight from a speculative run.

Spahn explains his two-tier taxation impost as a "regular" CTT as the first tier and an Exchange Rate Normalisation Duty (ERND) as the second tier. It is an expansion of his "Spahn Tax" first proposed in 1997. The ERND remains dormant whilst exchanges on a global or country-to-country basis are not outside acceptable corridor trading limits. Once triggered, a pre-determined tax rate is applied to all transactions. This would be adjusted in accordance to the perceived severity (or the actual severity) of the outflow volumes. The end result, Spahn says, would ideally be a return to, and reinstatement of, stable market conditions.

The ERND would be unilaterally implemented by developing countries, emerging markets, and developed countries that currently lack formal currency arrangements (such as the "pegged agreements between the United States and China, and South Korea). Spahn specifies the main purpose of the ERND is to reduce externalities of the international currency markets (e.g. excessive speculation against vulnerable currencies). Nation-states, especially developing nation states, could have the added advantage of modifying the tax rate according to their own policy settings and pre-determined positions.

The Spahn proposal also has a substantial positive effect in that it protects developing countries from speculative surges by wealthy developed countries and traders in offshore centres. This aspect is of critical importance, as it would tend to even out the bias that exists in favour of developed countries and offshore financial centres.

For developing countries, the Spahn second tier would strengthen, and have the capacity, to produce revenue via high charges on capital leaving sovereign nation state borders at times of crises when central banks are under extreme duress. Instead of languishing in reduced positions following capital flight, developing countries could have the prospect of having a system in place to resist the shock, and the mechanisms to stabilise the situation by raising income from a CTT. Thus substantial charges would be levied on outflow capital which would have the effect of dampening flows and producing concomitant revenue to assist the state. These are the major bonuses of the Spahn proposal.

The disproportion in the global currency trade between developing and developed countries cannot be underestimated. Spahn (2002:3) argues that it is “one of the asymmetries between developed and developing countries in the times of globalisation”. Spahn points to the fact that on one hand the central banks with strong currencies, such as the US Federal Reserve or the European Central Bank, would be largely independent of effects of exchange rates whereas the central banks of developing countries are continuously obliged to stabilise and defend their currencies against runs of exiting capital, with debilitating social and economic consequences.

The developing countries' central banks are left with no choice but to prop-up their currency positions with hard earned foreign exchange reserves (Waldow and Wahl 2002). The ERND would be an invaluable tool in the process of strengthening the central bank position. Another bonus to developing countries which utilised a Spahn-style second tier ERND economic policy is that it would add to the integrity of the money supply and would offer prospective investors more assurance of stability in the local economy.

Spahn has gone to great lengths to argue that the criticisms of his proposal are misplaced. For instance he says that one of the major impediments at the time he first outlined his proposals in 1997 was that the model would be ineffective because of administrative and bureaucratic processes, which were deemed to be unmanageable. Spahn argues that these processes are far more viable given the considerable advances in IT and computer systems. He asserts that the monitoring process is more realistic and viable than it was in 1997.

This view is strengthened by the innovation of Continuous Linked Settlement (CLS) as an international facility to monitor currency and associated trading. Importantly Spahn points to a study of a working group of the European Parliament that revealed that the implementation of the tax fully complies with the Maastricht Treaty and other significant international treaties. The implementation of the CTT would be enforceable in international law. This is a major political advantage.

Another technical aspect of the Spahn proposal is that implementation coordination is complemented by the existence of the CLS as opposed to the more regional and ad hoc approaches of decentralised international monetary policy. Both the CLS and the BIS create integrity for a CTT proposal. Both provide the necessary degrees of transparency.

When speculative attacks occur against a currency, the conventional policy instrument of central bank intervention creates circumstances in which the currency rate can fluctuate wildly. Speculators may continue to view the currency as weak and likely to devalue further, creating an incentive for even larger “betting” positions. Continuous destabilising speculation can prove intolerable and the original currency position may not be recoverable. The “central tax policy model” (Spahn, or combination of Tobin or Spahn) would provide a strong structure, instant transparency of information, and a rigorous corrective procedure. These are effective policy management tools to use in reaction to a crisis

One criticism of Spahn's recent work is that he anticipated that there would be a lessening of monetary evasion by traders because the trading of currencies and other instrumentalities (derivatives, options, futures etc) would be minimised as the larger trading houses merged and centralised away from offshore locations. This assumption appears to be flawed as the spread of dealers has never been so widespread and opaque and the proliferation of offshore centres has been a dominant feature of recent global capital markets.

The appeal of Spahn's model is evident in recent proposals put forward by European governments, most especially in the Belgian proposals. The Spahn Two Tier proposals give a range of flexible options and broader controlling mechanisms. Whilst Spahn, influenced by Tobin, has developed a strong approach to CTTs that improves and broadens its range, his work also complements that of another leading proponent of CTTs, Rodney Schmidt.

SCHMIDT'S MODEL

Rodney Schmidt is an economist. On graduating he worked with the Canadian Governments' Department of Finance in Ottawa. In the mid 1990's Schmidt was given an assignment to investigate the feasibility of a Tobin tax to operate in the broader international financial community. The Canadian Finance Minister, Paul Martin, had an interest in Tobin's proposals and supported the Schmidt project. Martin planned to raise the issue at a G7 Conference in Halifax.

Schmidt's departmental supervisors made it clear that he was to come up with ideas to oppose such a tax, a position that was entirely consistent with most Western developed government thinking at the time. Martin, however, was aware that by bringing the proposal of a Tobin Tax to the Halifax meeting he would be guaranteed of some high level support which would lift his profile as a politician with strong social and economic ideas. Two high profile supporters were Lloyd Bentsen (then Secretary of the US Treasury) and Laurence Summers (deputy treasury secretary in the Clinton Administration).

Schmidt would have been aware of the levels of acceptance in Europe and the support that had been forthcoming from the ministers of governments in France and Germany. Finland and other Scandinavian countries had openly expressed optimism for the CTT proposals. Canadian Prime Minister Jean Chretien had shown support for Tobin's proposals. Schmidt's paper to the G8 meeting concluded that the Tobin tax was not workable. He had completed a paper that his supervisors would have been pleased to read. They would have been encouraged by the negative sentiments expressed.

Following the collapse of the Mexican Peso (whose social and economic effects are still being felt ten years on), and the associated widely felt economic and social dislocations, Schmidt again applied himself to the task of looking for an accurate assessment of the feasibility of existing works on currency transaction taxes. This assessment was undertaken against a scenario of a rapidly expanding global speculation trends. Schmidt notes that in the new world of currency speculation a whole new range of financial trading instruments were becoming popular including spot trades, options, forward swaps and whilst becoming exotic in nature they were entirely divorced from the "normal" instruments of foreign exchange trading. They were exotic accessories to the main game but becoming extremely popular in global trades.

Schmidt noted that in 66% of outright forward and swaps transactions the monies moved into other currencies for less than seven days and that 86 % of transactions were with and between international branches of the same banking systems. These foreign exchange arrangements were becoming the major part of the banks' core business and these circumstances have become a feature of global banking businesses and profit trends. Schmidt concluded that whilst volatile currency markets were "bad" for national economies, the levels of volatility translated into very profitable margins for traders.

After close technical analysis of the nature of global trading and the political economy of financial markets, Schmidt concluded that his original rationale and conceptual approaches had been wrong. Schmidt submitted his second paper to department supervisors who refused to pass the paper for wider distribution. Schmidt subsequently resigned from Canada's Department of Finance and joined a project of the Canadian based International Research Centre in Hanoi, Vietnam, where his contribution to the CTT debate was valued and encouraged (Schmidt, Rodney, International Development Research Centre. Government of Canada (Vietnam office) and currencytax.org/files/research_items/scmidtjune2000.pdf -).

From his new position Schmidt was able to observe that following the Mexican Peso collapse the Canadian Government complied with a request from Washington to issue Mexico a US\$1 billion line of credit as part of the international US\$50 billion bailout package. The irony was that the US\$50 billion bailout package was channelled to investors in Japan, Europe and the US who had suffered speculative loss in the course of destabilising the economic and social settings in Mexico (Schmidt 1999:1). He concluded that more attention is given to repay losses to speculators than to assist in social and economic infrastructure recovery in the state. Linda McQuaig (1998:283) noted that:

We have become convinced that we are collectively powerless in the face of international financial markets. And with the widespread acceptance of this view the rich have proceeded to create a world in which the rights of capital have been given precedence over and protection against interference from the electorate.

International rescue packages are a common and accepted part of the deals that flow from major currency collapses and corporate implosions. From Long Term Capital Management to the Mexican and South American crises to the Russian currency crisis and Southeast Asia all the bailout monies are forthcoming from sources derived from tax revenues in developed countries. These funds could have been channelled to the betterment of citizens or toward foreign aid that was socially productive rather than redirected to compensate the losses of speculative investors.

Schmidt argued that when the funds do arrive to assist "in -need" countries they come with caveats that require strict adherence to policy settings that banks and investment

houses recoup their losses in the first instance. This is carried out under the auspices of “free market” ideology that favours rich over poor countries. As previously noted the IMF provisions for restructuring are known to carry heavy penalties to states not adhering to demands for economic and social change toward “free market paradigms”.

With the Vietnam Economic and Environment Management group of the International Development Research Centre, Schmidt wrote a further paper considering the CTT for the Canada’s North-South Institute. This paper, entitled “A Feasible Foreign Exchange Transactions Tax”, promoted Schmidt as a leading authority in the CTT debate. The paper is a succinct interpretation of the issues that were current at the time the paper was constructed (1999). The paper takes note of those leading exponents who support the CTT in principle (Frankel 1996; Garber and Taylor 1995; and Ul Haq 1996) but is reserved about its implementation, citing the lack of enforcement policies evident between participating parties or nation states. Schmidt quoted Frankel (1996:156) on CTT global compliance as:

Enforcement is a big problem. Certainly if some countries adopted the Tobin tax but others did not, the foreign exchange trading would simply move to where it was not taxed. For this reason, everyone agrees that it would have to be imposed in virtually all countries, large and small. This would require more widespread support than seems possible politically.

Schmidt considered that the decentralised nature of the markets would prohibit the possibility of collecting a tax, which would be equitable only across all participant states. This would, he concluded, be the main drawback, and along with other proponents (including Eichengren, Tobin and Wyplosz), supported progressing the debate on a centralised collection system. Schmidt further argues that traders can find mechanisms to hide trades and positions by shifting them between branches of their own banks or corporate houses in different time zones.

Other issues that Schmidt raised included the possibility of being able to differentiate foreign exchange transactions from domestic financial payments. Also highly contentious is the issue of taxing foreign exchange transactions originating between banks and trading houses with in-shore configurations and bases whilst also having

the ability to level the same tax imposition on those taking place off-shore. Schmidt urged that whilst it is feasible and technologically possible to apply a CTT in both domestic payment systems and international netting systems, it remained to be seen whether it was possible to convince policymakers of the possibility of serious concentration of resources to impose a CTT which provided a degree of political and economic management, and governance, with concomitant social benefits resulting from stable markets.

TOBIN, SPAHN AND SCHMIDT COMPARED

Tobin first proposed his tax in 1972 in response to the “herding instincts” of investors. He proposed a levy on international currency transactions to make the system accountable. The Tobin tax (with a range of percentage options) was designed to discourage short term runs of capital, especially those resulting from herd behaviour. Although not part of his main directive the revenue available for states imposing this tax arrangement could be considerable. This model proposed accountability for capital market players and revenue for the state. The Spahn model which has become increasingly popular in Europe would have a two - tier approach. The first tier would have a similar or perhaps lower effect than Tobin’s models on short term transactions but would have the added benefit of a second tier which would be triggered during excessive capital runs. This second tier would have a high rate of tax which is designed to substantially slow potentially excessive capital runs.

Schmidt has supported a centralised global collection system on all currency trades in much the same way as Tobin and Spahn. Schmidt was concerned that the decentralised nature of the markets could prohibit the possibility of collecting (or imposing) a tax and his theoretical position supports a universal system. This is consistent with recent European positions that have seen legislation enacted to be enforced when other states agree to a common formula and legislative agenda. Schmidt was convinced of the feasibility and technological possibilities of a tax but held little hope of universal acceptance against the strong opposition from the United States. He saw the advent of the Continuous Linked System as a breakthrough.

CHAPTER SUMMARY

While critics have disputed the feasibility of a CTT for over a decade based principally on the need for uniformity of tax applications and centralised collection, these problems have now been largely resolved. In particular, the emergence of the Continuous Linked Settlements (CLS) system has formalised international payment and settlements. With advances in information technology it is reasonable to assume that the CLS and/or the BIS could monitor international financial transactions. The CLS now has a working international structure capable of playing a central role in the mechanism of transactions, settlements and presumably the collection of a tax drawn from the proposals of Tobin, Spahn, Schmidt and others. This chapter has argued in favour of the technical feasibility of the CTT proposals, highlighting the fact that the major problems confronting implementation are political. And it is to the political feasibility of a CTT that I turn my attention in the next chapter.

5. CURRENCY TRANSACTION TAXES: POLITICAL POSSIBILITIES

INTRODUCTION

The previous chapter outlined several of the technical economic proposals for a currency transaction tax, ranging from Tobin's initial proposal to more recent ones from Spahn and Schmidt. The economic literature, while not unanimous, provides a solid technical base for the implementation of a CTT. Such a tax would not only be economically feasible and reduce financial market volatility, but could also raise significant funds to pay for a range of globally necessary products and services, especially related to Third World development and the achievement of the United Nations Millennium Development Goals.

Most proponents of a currency transaction tax agree that single -country controls on currency transactions are technically easy to evade. The controls imposed by individual states are often complex and obscure and government efforts to monitor currency trades are not necessarily well equipped to deal with the speed, innovative capacity and flexibility of currency trades and traders. Also, the continuing implicit and explicit opposition of the United States to a CTT undermines the entire approach for universal support. Without a universal support traders will move from states imposing a CTT to another state without restrictions. The secretive and unregulated nature of the currency transaction markets allows this freedom of market choice.

This point is pursued by Zee (2004:1) and Nadal -De Simone (1997) who argue that the feasibility of the currency tax in the global context is compromised by economic, administrative and political complexities. The central point in the international acceptance argument is that if one or two states chose not to join in a global tax arrangement then the integrity of the international model would not stand. Rightly, Nadal – De-Simone and Zee concur that distortions in the global transaction markets would be generated by actors operating independently and would result in a breakdown in any over-arching model which could only be managed by uniformity and common policy approaches.

From this there would be corresponding distortions in the way that revenues could be distributed. Revenue distribution is a major positive feature of a new CTT model.

These are potential problems, but may not be insurmountable. This chapter outlines several political approaches that could lead to their resolution.

The problems confronting a CTT appear to be mainly political rather than technical. In this chapter, I chart the growing pressure on governments around the world to develop a CTT, as well as financial industry and “free market” resistance to its implementation. I argue that a CTT could eventuate in one of two ways — incrementally, via the steady adoption by others countries of the Belgian approach; or *tout court*, should another global currency crisis occur, especially if it threatened the already vulnerable US economy.

HEDGE FUNDS AND THE RISK OF FINANCIAL CRISIS

Analysts are becoming concerned about the storm clouds that are gathering on what could turn into the biggest meltdown in capitalist markets since the Depression. News editors from conservative bulletins such as *The Economist* and popular international broadsheets have been running articles about the dangers of burgeoning capital markets. Concurrent articles through the latter half of 2004 and again in 2005 in *The Australian*, *The Guardian*, *The Bulletin*, and others have retailed a consistent theme on volatile and fragile market conditions. There are many concerns, but the major one is the continued growth of hedge funds.

Hedge funds have a significant capacity to destabilise global financial markets as the saga of the Long Term Capital Management (LTCM) case graphically illustrates. It is pertinent to quote at length from a recent article to illustrate the nature of the problem:

Speaking before an audience stocked with hedge fund managers Wednesday (19 October 2005) Connecticut Attorney General Richard Blumenthal called for stepped-up regulation of the hedge fund industry, which has grown to nearly \$1 trillion in assets under management amid some high -profile scandals and collapses. Blumenthal, in New York City at a hedge fund conference sponsored by Institutional Investor magazine, said states - including Connecticut, where many of the funds are located - "could supplement and backstop a Securities and Exchange Commission that is already overburdened with enforcement and regulatory responsibilities The task force may look at disclosure requirements, conflicts of interest, government enforcement, fraud penalties and auditing requirements, he said. Blumenthal referred to the recent collapse of Stamford -based Bayou

Management and guilty pleas on fraud charges by its principal and chief executive Samuel Israel III, 46, and former chief financial officer Daniel Marino, 45. They admitted to investment adviser fraud, mail fraud and conspiracy. Government oversight and scrutiny, indeed regulation, is no longer a question of when or whether - the time is now - but how much and what specific steps," Blumenthal said (Hartford Courant. Hedge Funds in the Spotlight October 20 2005).

The Economist (Feb 17 2004) points out that perhaps the only way to evaluate how the individual risk-management models on quantum positions can be ascertained is by looking at Value-at-Risk (VAR) models which banks use to determine the amount of capital they set aside against their trading risks. These figures are required to be shown on the banks' financial statements. Rising VAR indicators show the banks are taking more risk and have larger outstanding positions than at any other time in history. Milton Friedman calls this situation a bubble and all agree that it is not sustainable.

In 1990, the estimate of reserve funds held by hedge funds was \$US50 billion. In 2005, hedge funds manage almost US\$1.3 trillion. Part of this growth is attributable to the further emerging dynamic of funds-of-funds, which provide trading houses with a mechanism for a greater spread of risks across trading mechanisms. The funds-of-funds are expanding by an incredible 50% in volume each year, albeit off a low base. Funds-of-funds invest in hedge fund mechanisms (in their own equity base and funds placed by investors) borrowing up to four to one in leverage from banks (*The Economist*, June 12 2004).

They are actually betting with borrowed leveraged money in the international marketplace in scenarios similar to LTCM. Hedge Fund Research (2004) estimates more than half of existing funds-of-funds are borrowed funds in a system of tier-to-tier leveraged debt. One London funds of funds manager says, "It's a house of cards...each level of debt amplifies the rest...and that is hard to manage" (*The Economist*, June 12 2004:65). Walsh (*The Bulletin*, June 22 2004: 55) argues that in the event of a hedge fund failure it could well precipitate corporate failures at least of the magnitude of the Long Term Capital Management (LTCM) crisis in the United States, but on a systemic basis. LTCM also had a massively geared trading portfolio. It used its US\$2.2 billion capital (in the form of investors funds) to buy US\$125 billion in securities. It then used these securities to lever into derivatives worth US\$1.25 trillion. The LTCM debacle was confined to one corporation whereas the hedge fund system is now highly geared and diversified (as well as being very secretive) and linked inexorably to currency speculation positions.

One salient point that leads to further anxiety is the unknown quantum figures about the extent and influence of the carry trade as part of the larger picture of global economic trades. This unknown area is consistent with the secrecy of financial players that is alluded to as a constant theme in this thesis. There is, for example, no direct method of realising the volumes involved in hedge fund trading in and out of Australia and no instruments or policy settings in place to correct the potential of a mass run of funds exiting this country during times of crisis. The possibility of crises is very real.

Since 1998 the global carry-trade in conjunction with other global financial exchange instruments has seen massive growth whilst at the same time becoming less and less transparent through offshore tax avoidance havens. This lack of transparency must be a major issue for governments in developed and under-developed emerging economies. It further emphasises the intersection between responsible governance policy and the awkward relationships that have developed with financial market players (*The Bulletin* June 22 2004:56).

In *The Economist's* (17/2/2004), Global Agenda section entitled “The Coming Storm” a reference was made to the importance of the lack of lessons learnt in the wake of the Long Term Capital Management debacle in 1998. *The Economist* and similar-themed news magazines and journals refer to the LTCM meltdown as a defining event that could be repeated. These references are now regularly made. The inherent problems with capital loss from hedge funds in mid-2005 serve as timely warnings of risks with global financial markets. The risks associated with currency market vulnerability and the possible scenarios have been pointed out at length in this paper and it is sobering to acknowledge the warning signs being flagged by leading business journals. *The Economist* is not alone in expressing the concern of markets and policy makers who are becoming extremely nervous in light of recent developments involving banks and trading houses across the globe. Given these circumstances it would seem a matter of urgency that states would find ways to sort through the existing frameworks on this subject to find common ground.

GROWING GLOBAL FINANCIAL REQUIREMENTS

In line with catastrophic global events such as the tsunami on Boxing Day 2005 and the internal wars and poverty crises in North Africa (Darfur) there have been calls for an international fund raising effort to support relief and development programs. In Darfur alone the extreme human cost has seen the number of displaced persons (who have not been assisted) rise from an estimate of 800,000 in December 2004 to 2.3 million in December 2005 (SBS “They said it would never happen again” November 2005). Prior to and during these events the United Nations had called for new forms of funding the commitments toward the Millennium Development Goals (MDGs). There is an urgent need to provide funding for environmental “natural” disasters which appear in increasing numbers and severity. The aftermath of the hurricane in New Orleans and southern United States is said to be the most costly in history. The incapacity of nation states to fund rescue efforts has never been so obvious yet the United States wilfully blocks any move by the United Nations to investigate alternate means of finance such as a currency transaction tax.

One of the problems facing states in their attempts to fund programs like the MDG is that an increasing amount of revenues normally expected by states is being squirreled away in tax havens, untraceable and cunningly concealed. Currency transaction players, corporations, medium-sized business, and increasing numbers of entrepreneurs are taking advantage of tax haven and international accountancy firm promotions of secrete funds in tax havens and to park capital through increasingly skilful evasion instruments.

Without regulation, (even with regulation), and without governance, capital market players will always take advantage of tax minimisation schemes and tax evasion. So successful have been the extensive promotions from tax havens securing corporate and capital accounts, that the state is forced to fund obligations for poverty, disaster, and third world development from internal funds from PAYE taxpayers. The dilemma for states is that un-regulated markets are getting bigger, and more corporations than ever are hiding and manipulating their earnings and laundering profits.

The state is continually being drained of revenue for humanitarian relief but also for downgraded infrastructure, public health and education systems and ports, roads and transport. This is a case in point illustrated with the problems associated to the road and tunnel network in Sydney where consumers are increasingly asked to finance new developments by private actors through the toll system. (ABC 7:30 Report 20 October 2005). These are some of the growing number of global financial requirements as states transfer infrastructure arrangements to the private sector. There is an urgent need to re-regulate and to make capital markets at least accountable, and taxable.

A RETURN TO REGULATION

There is evidence that institutions such as The Basle Committee on Banking Supervision (BCBS), the Bank for International Settlements (BIS), the International Organisation of Securities Commissions (IOSCO) and a host of state-specific organisations such as the US Security and Exchange Committees are placing strong emphasis on reports relating to foreign exchange transactions. A host of technical reports on types and volume are circulated but until recently there was very little available on policy issues. Until recently, prudential regulation designed to shape the conduct of private financial institutions has not been a priority of these institutions (Porter 2001).

In July 2004 there are reports that the US Securities and Exchange Commission has decided to place regulations on hedge funds, funds of funds, and derivatives in the United States (*The Economist*, July 18 2004). This is an astounding move given the prior reluctance to touch these issues previously. There is now evidence of an emerging desire to press toward regulatory practices particularly in respect to transacting foreign currencies.

In an attempt to understand the nature of financial instability and to coordinate responses, the BIS and a group of writers and academics, including Phillip Lowe, Bengt Mettinger, Hyan Shin, and Kostas Tsatsaronis, have contributed to the debate. The BIS has called for new ways of understanding and estimating the likelihood of economic swings and downturns. These sets of data are broadly encapsulated under the heading of macro prudential financial orientations. These new models represent an increasing surveillance opportunity on financial instability.

Governments of nation states are being urged to take measures that will help alleviate the social and economic suffering caused by waves of currency runs and bankruptcy. The actions of the BIS and others in steering a course into uncharted waters is seen as a positive reaction to challenges from left-of-centre political parties and green movements who have found popular support bases as protests against global financial players and associations become more common in the United States and Europe.

An essential component of analysing the movement of speculative capital on a global basis is interpretation of past and present history. Macroprudential and microprudential models can now be examined along with surveys of volatility occurrences, which are known as autoregressive conditional heteroscedasticity (ARCH). With research conducted through empirical modelling it is thought that the resultant findings will go along way toward “improving further the lines of defence against financial instability”, strengthening the orientation toward a better understanding of what is required in the way of regulatory and supervisory frameworks. Friedman once wrote that “We are all Keynesians now” and BIS suggests that “We are all (to some extent) macro-prudentialists now”, concluding that the developing ideas toward ameliorating financial instability has been quite remarkable and growing (BIS February 2003:47).

Table 5.1: Comparing macro and microprudential perspectives

Legend	Macro prudential	Micro prudential
Proximate objective	Limit financial system-wide distress	Limit distress of individual institutions
Ultimate objective	Avoid output (GDP) costs	Consumer (investor/depositor) protection
Model of risk	(In-part) endogenous	Exogenous
Correlations and common exposures across institutions	Important	Irrelevant
Calibration of prudential controls	In terms of system-wide distress: top down	In terms of risks of individual institutions; bottom-up.
Autoregressive conditional heteroscedasticity	Provide matrix for study to limit distress	Useful

Source: BIS Working Paper 128 p.2. February 2003

The objective of the microprudential approach is to limit the risk of episodes of financial distress at individual institutions, regardless of their impact on the overall economy. The objective of the macroprudential approach, on the other hand, is to limit the risk of episodes of financial distress with significant losses in terms of real output for the economy as a whole.

There are signs, therefore, in the global economy, that analysts and policymakers are becoming increasingly concerned about the potential for hedge funds to generate significant instability that could be translated from the microeconomic sphere of a single firm or a few firms into a system-wide macroeconomic problem via currency markets and the “herd instinct” of market players. There are also signs that these matters are beginning to get some political traction among governments, the subject of the next section.

GROWING POLITICAL SUPPORT

Keynes saw a government’s key task as stabilisation of investment. Friedman saw it as the stabilisation of the money stock. They are each much closer to the other than to Hayek, Schumpeter, Harberler or Pigou who dominated macroeconomics before the Keynesian Revolution (DeLong 1997). There is a growing movement of concerned citizens who are considering responses for far-reaching reforms of the

global currency transaction system. Repercussions from Southeast Asia's capital crises renewed calls for political responses. Most notable amongst the early post-crisis proponents for reform was the Canadian non-government organisation (NGO) known as the Halifax Initiative. The Canadian Parliament, in March 1999, responding to the pressures of the NGO, approved a motion on a currency tax. This motion to bring the currency transaction tax proposal forward detailed the opportunities and benefits from such a proposal and concluded that a CTT was advantageous and "presents a critical opportunity --- to reclaim some of the sovereignty we've lost as a result of economic globalisation" (Barlow 1999:52). This motion was hailed as a politically progressive proposal that gives prominence to a tax on international currency transactions; the cornerstone of a new international financial architecture (Williamson 2000:251).

Introducing the concept to the Canadian House of Commons on October 28, 1998, Member of Parliament Lorne Nystrom described the CTT as a "feasible part of the new world order". Nystrom explained:

If there was a 0.1% CTT on foreign currency transactions it could raise (in 1995), US\$176 billion. A Tobin Tax of just 0.003% would be enough money to fund UN peacekeeping around the world. There would be a strengthening of international organisations. The United Nations would become a meaningful world government—there could be permanent international peacekeeping forces.

The Tobin Tax vote, held on March 23 1999 passed by a majority of 164 to 83 on the proviso that the legislation would be triggered when there was further "global community support".

In June 1999, over 100 non-government organisations (representing 30 countries), issued a joint statement entitled 'A Call to Action: A Citizens Agenda for Reform of the Global Economic System'. This statement coincided with the June 1999 Summit Meeting of G8 ministers representing industrial countries through which most of the international speculative currency transactions are negotiated. The document proposed reform of the International Monetary Fund, a tax on currency transactions and other forms of capital controls.

Transaction proposal activity has been growing steadily, particularly in Europe (within the Scandinavian countries) and in North America. It could be observed that support for CTT's grows rapidly during times of obvious economic and social disruption, and then dissipates when other larger social and economic issues become prominent. As previously noted there is every reason to persist and maintain the argument for CTT's during this time because of the continuing inherent destabilising effects of crises, which are bound to occur again. Recent events make a CTT an issue of national importance. The massive increases in transactions create a clear danger to global markets. Most arguments against a CTT suggest that unless all trading states agree there can be no over-arching policy frameworks. Traders could bypass those states with legislation.

Support for a universal approach is growing. Further political backing came from the current President of the European Union, Belgian Prime Minister Verhofstadt, who presented the "Priorities of the Future Belgian Presidency of the European Community" to the Consultative Federal Committee for the European Agenda. Point 17 of Verhofstadts' "note of priorities" entitled "Global Thematic Approach" promised to implement a feasibility study to introduce a tax on global speculative capital movements (Social and Economic Policy Forum 2001). Proponents saw this proposal as extremely encouraging given the negative reaction to earlier similar calls from neo-conservative lobbyists in the United States.

France became the first major European industrialised country to support proposals for a tax on international financial transactions. Lionel Jospin (then French Prime Minister) said in August 2001 that France supports a Tobin type tax and that France will support a Belgium initiative for a full EU debate. Lionel Jospin was a very strong CTT supporter who saw this attempt to be realistic and feasible. In a television interview, he said:

The Belgium President plans to submit the question of the Tobin Tax in the European framework. I support the idea that France proposes that the EU takes the initiative on this in the international framework. If we can find wider support then we really can change the lives of millions of people in the developing world by raising some serious money and calming (volatile) world (money) markets at the same time. We will be watching Gordon Browns (UK Finance Minister) reaction closely (War on Want, Aug 2001).

Hubert Vedrine, French Foreign Minister said, “We shall pursue our efforts toward a humane and controlled globalisation, even if the new high-handed American unilateralism doesn’t help matters” (BBC News 29/9/2001). Jospin went further saying the French were the key to turning the idea of a Tobin Tax into a political reality. Both Canada and France were prepared to legislate for CTT’s if they could find “wider support”. France became the prime mover and sought to raise the issue at every opportunity.

In the latter part of 2004 the Presidents of France, Brazil, Spain and Chile joined the United Nations Secretary General Kofi Annan and stated that a tax on foreign exchange transactions is feasible on a broad global level. Their joint release coincided with a UN report on financing development entitled “Action against Hunger and Poverty” on 20th September 2004, which had the support of 110 countries. This has been followed by a joint communiqué from the Presidents of France (Chirac), Brazil (Lula), and Spain (Zapatero) addressing the need for an examination of CTT’s to provide funds for the fight against poverty. President Chirac called for financially realistic and rationally developed funding mechanisms and noted that senior IMF and World Bank officials have accepted the feasibility of CTT’s to finance this development.

This call to advance the cause of the CTT follows on from the legislation passed in Belgium in July 2004. This international support has renewed and reinvigorated groups worldwide whose support for a CTT had waned in the face of intense negative pressure led from the United States. This represents a new exciting phase for the CTTs’ hundreds of thousands of global supporters who often operate from grass roots community levels.

In London, twenty thousand CTT supporters converged on the City in October 2004 for the European Social Forum (ESF). Tobin Tax groups from Belgium, Denmark, Finland, France, Germany, Holland, Italy, Ireland, Norway, Spain, Switzerland, and the UK as well as Costa Rica, Japan and India met in plenary and in seminar and workshop education sessions to foster and gain more knowledge about how the tax could be implemented.

Newly elected President of Spain (Mr. Zapatero) is preparing to introduce CTT legislation in his country. In Ireland, Susan George, a leading intellectual and author on development economics urged the Irish Government to use its Presidency of the European Union to push for an EU resolution on introduction of a CTT. George said

the EU should not be discouraged by the US opposition and said that the Tobin Tax should be introduced at a regional level initially. It should start with the Euro and could be rolled out for other currencies after that. If you sit around and wait for the Americans you will be waiting forever. Europe is going to have to take the initiative (Hillman 2004:2).

As already noted, models for taxation proposals have been presented by Spahn, in his work entitled “International Financial Flows and Transaction taxes: Surveys and Options” (1995) and by Rodney Schmidt (1995) and Leiven Denys. An influential work by Ul Haq, Kaul and Grundberg (The Tobin Tax: 1996) drew favourable responses, and contributed to the debate by detailing arguments for and against proposals, and providing models on capital flows and possible revenue offsets.

The United Kingdom, French, Belgian, Brazilian and European parliaments have held debates or hearings covering a range of proposals and models. In June 2000, over 160 governments agreed to undertake a study into the feasibility of currency transaction taxes, at a meeting of the UN Social Summit in Geneva. Over 500 parliamentarians worldwide have endorsed initiatives of support for an open dialogue on the issue of taxation proposals and additional support has been forthcoming from unrelated groupings including social, economic and environmental groups and NGO's. In January 2000, The Capital Tax, Fiscal Systems and Globalisation Intergroup of the European Parliament initiated a resolution calling on the Commission to report within six months on the feasibility of the CTT proposals.

In the European Parliament a draft bill for the Currency Transaction Tax was lost by only four votes. The Finnish Government prepared legislation to be introduced in its coalition agreement but this stalled after considerable debate. The United Nations set up a formal working group to assess the potential and feasibility of a tax system and a separate paper by the UN Department of Economic and Social Affairs gives

support to a currency tax (United Nations Department of Economic and Social Affairs. New Sources of Development Finance 15 November 2004).

Recently however interest by government working groups and NGO's has dissipated as other pressing political and economic issues gained centre stage. The tsunami in Southeast Asia, Hurricane Katrina, the war on terror, and continuing needs for money to fund the MDG's, however, will see the CTT back on the international agenda as states look at means of producing sources of revenue to assist the region to reconstruct.

The currency transaction tax was a focal point of the March 2002 UN Conference on Financing and Development. An International Monetary Fund study has shown support for a variation of a currency transaction tax as a "reasonable contribution" for stabilising the international monetary system (Zee 2002). Another recent, and unlikely, source of support has come from the owner of one of the largest currency investors, The Quantum Fund, and one of the most prominent currency speculators, Mr. George Soros. Soros called for the tax, on the basis of his internal knowledge of currency transactions and global financial trading systems, during a television interview conducted at the World Economic Forum in Davos, Switzerland in March 2001.

Warning of the dire consequences associated with the proliferation of the growing foreign exchange trade in derivatives (which rose from US\$400 billion in 1992 to US\$1,000 billion in 1998 and is now estimated at US\$45 trillion) Soros said:

Generally speaking there are no margin requirements for derivatives, swaps and forward transactions except when they are executed on registered exchanges. Banks and investment banks acting as market makers can carry these items on their off-balance-sheet items. These instruments have developed in an age when people believed in efficient markets, rational expectations, and the self correcting capacity of financial markets. By contrast, market requirements on stock purchases are left over from a bygone age. If my contention is correct and some of the recently invented financial instruments and trading techniques are based on a fundamentally flawed theory of financial markets, the absence of margin requirements may pose a serious systemic risk. (Soros 1998:189).

Trade unions, including the European-based German Trade Union Confederation and the US-based American Federation of Labour and Congress of Industrial Organisations (AFL-CIO) in the US, support the CTT concepts. One of the civil society groups which have become most prominent is the French group *Association pour une Taxation des Transactions Financiers pour L'Aide aux Citoyens* (ATTAC). The driving force of this movement (which globally emails 18,000 newsletters for further distribution fortnightly) is for the regulation of speculative financial transaction markets in order to achieve economic accountability as well as a socially equitable and an environmentally sustainable society (World Economy, Ecology and Development. Feb. 2001).

RESISTANCE TO CURRENCY TRANSACTION TAX PROPOSALS

Resistance to currency transaction taxes is deep-seated in the global capital market communities dominated by the idealism of neoliberal economics. Opposition is entrenched in the three main trading states of the United States (US), United Kingdom (UK) and Japan, whilst there is some evidence that European countries (Belgium, Luxembourg, Spain, and perhaps Britain) support proposals but only if wider acceptance is forthcoming from the global community.

New York, London and Tokyo are the three main trading centres for currency trades and hedge fund activity. New York and London have offshore status and each interlinks with the myriad of tax havens around the world. The US, UK and Japan are the main proponents of financial deregulation. Whilst the US has recently taken steps to tighten regulation on funds through the Securities and Exchange Commission there is evidence that the coalition of capital interests (banks, traders, politicians, wealthy individuals, and corporations) have in the past, and continue to use, considerable political leverage to fend off moves to regulate foreign currency trades through the agency of a CTT.

Speculative capital market players openly supported the neoliberal model of free markets promoted at the end of the 1970s by Margaret Thatcher in Britain and Ronald Reagan in the US. Neoliberalism legitimised the unprecedented growth of financial markets, with Thatcher's first Act of Parliament on election in 1979 being the granting of offshore status to the City of London. London quickly consolidated

its position as leader in global financial markets and particularly currency trades. Its influence increased further as the euro-dollar market expanded enormously.

Helleiner (1994:82), however, notes the importance of US hegemonic support for these UK capital market developments:

US support was equally important because American banks and corporations were a dominant presence in the markets in the 1960's. Although it had the power, the United States chose not to prevent them from participating in the market. In fact by the mid 1960's, US officials were actively encouraging American banks and corporations to move their operations to the offshore London market.

At the same time, the US took steps to open its capital markets. The powerful New York banking community successfully lobbied the US Treasury to operate its own "offshore" financial centre, which opened as the New York International Banking Facilities (IBF) in December 1980. The integrated offshore centres in New York and London had similar clients and facilitated trades between bank branches located on either side of the Atlantic. The UK and US developments greatly assisted the cause of financial deregulation promoted under the Thatcher and Reagan market liberalisation regimes, being able to compete on a level basis with the tax havens and offshore banking facilities in Bermuda, the Cayman Islands, the Isle of Man and Jersey among others (Patomaki 2001:174,175). By 2000, New York and London accounted for over half of all unregulated global foreign exchange transactions.

The policies to establish and promote the growth of these two major offshore capital markets aimed to forestall debate about the volatile and unstable nature of capital market trades. Their establishment dampened efforts to introduce a currency transaction tax as a vehicle to re-regulate trades. The policy of resistance to any impediments to the free running operations of markets was orchestrated by a group of financial interests centred in London and Wall Street. These markets included major central banks, banks, corporations, hedge funds, fund of funds, stock markets, HNWIs, and not so high net worth individuals who have taken an active role in speculative trades. These were the parties engaged in "casino capitalism" as described by Strange (1998).

The United States

The ambiguities of the political economy of international currency markets are most evident in political settings in the United States. On the one hand the US openly resists outside interference in its own economy and adopts a nationalistic stance in respect to internal market structures. The US opposes any criticism of its neoliberal economic orthodoxy whilst on the other hand it places strict conditions on developing countries to open financial markets to free trade ideologies. It virtually forces capital market expansion including opening further opportunities for currency market speculation through free market agreements. Whilst European countries (Spain, Belgium, Luxembourg, Germany, and France) have all been prepared to examine the merits of CTT's, the US (and to a lesser extent, the UK) have rejected any notion that a CTT has merit despite the fact that all of the models go at least some way toward ameliorating the debilitating effects of speculative currency runs. There is evidence that the US has successfully used its political clout to drown out the voices of those advocating CTT's.

Patomaki (2001:74) suggests that the Reagan and Thatcher governments openly challenged the UN Secretary-General Boutros Boutros-Ghali when he chose to look at international taxes as a way to help finance UN operations, with pressure, both real and perceived, taking the form of holding back funding of their UN financial commitments. The US warned Boutros-Ghali that his discussion of a tax on international airfares was an "attack on US citizens in defiance to the US Constitution". Immediately following the challenge levelled at the UN, the US introduced the Helms/Dole Bill to prohibit "voluntary and assessed contributions to the UN if the UN imposes any tax or fee on US persons or continues to develop and promote prospects for such fees" (Sweeney 1999). The US eventually succeeded in removing Boutros-Ghali from office and replacing him with their preferred nominee, Kofi Annan. Patomaki (2001:175) describes this as "imperialist behaviour by the US" and it should be noted that Annan came under similar pressure in recent times when he proposed international currency taxes to fund Millennium Goals and global disasters.

Pointing to the heavy-handed, non-diplomatic approaches made by the US Patomaki (2001:175) states:

In 1996 the US suppressed an attempt by the United Nations Development Program to circulate a volume of the expert papers on the Tobin Tax. The Collection entitled “The Tobin Tax: Coping with Financial Volatility” which is, incidentally, rather favourable to the introduction of a currency transaction tax, was eventually published by the Oxford University Press as an independent academic text with no mention of the UNDP. The rule was thereby stated. The US has the right to censor discussion on global taxation in the UN system.

Following the publication of the United Nations Development Program’s (UNDP), 1999 Human Development Report, in part, suggesting that “new sources for financing for the global technology revolution could be investigated”, a letter in opposition was sent to the UNDP Administrator restating the US’s position (UNDP 1999:13). As reported by Patomaki (2001:190), it was telling that a highly positioned UN civil servant (who requested anonymity) commented:

that nobody in the UN dares even mention the Tobin tax, particularly because of fear of the anti Tobin tax and anti UN sentiments in the US Congress. It is good that somebody raises the issue; the initiative must come from civil society.

The system of silencing voices in support of CTT’s has been extended to all international forums dominated by the US. These deliberate plans to oppose regulation of financial markets are written into free trade agreements and followed up by the US who wants open global markets.

The United Kingdom

As is the case the case in the US, the UK has blocked many initiatives to formally debate a CTT and although evidence exists of support from within the ruling Labour Party to move the debate forward these signs are tempered by the obviously close alliance between Tony Blair and George Bush and the failure of Blair to institute major change. Notably, the UK has not supported the proposals put forward in the European Commission. Whilst the more enlightened members of the UK government have discussed a CTT, including Chancellor Gordon Brown who is a strong advocate for tax proposals, so far Blair has not been convinced of its merits. There has been more enlightened and open debate on a CTT in Britain than in the US, however Regulation proposals have also been put forward to create a more transparent business structure for the City of London and its major currency trading roles.

Palan (1999:28) describes the position and development of offshore capital markets in the UK and notes:

The US and the UK have led the way in deregulation and that ...it is not wrong to say that financial deregulation has amounted to Anglo - Americanisation of practices; particularly in the OECD area, but increasingly everywhere. This has had far-reaching effects on the restructuring of relations of production, exchange, and accountability. Moreover deregulation has meant more room [for actors] to manoeuvre, new open markets, and the migration of money offshore.

Whilst it appears that a significant proportion of global wealth has migrated offshore from developed states all over the world the main transaction bases are still London and New York, with a significant share centred in Tokyo and more recently in Singapore. There is proof that the main political opposition comes firstly from the United States, with the United Kingdom close behind, but another state where financial markets are strong is Japan.

Japan

Tokyo has become the world's third largest financial centre behind the City of London and New York. Deregulation, particularly in the United States and Great Britain has greatly assisted the economic rise of Japan and of other Asian countries such as Singapore and India. Japanese banks are central players in foreign currency transaction markets. Japanese banks have become some of the largest corporations in size and influence in the world. Following its restructuring with financial aid at the conclusion of World War II, Japanese enterprises, businesses and corporations (with the assistance of US capital) became market leaders. Japan's economy ran into surplus and by the 1970's through to the early 1980's Japan's surpluses were financing US deficits.

While Japan's economy was controlled by the state for most of the post-war period, Japanese banks confirmed their position on the global stage and amongst global financial structures in an architecture that was quickly leaning to liberalisation and deregulation. The restructuring of the Japanese economy that took place after the oil crises of the 1970s saw the country forced to make decisions that opened up its public bond and financial markets. Susan Strange (1998:148) described this period as follows:

The high savings and low interest rates in Japan combined with low savings and relatively high interest rates in America increasingly tempted the big Japanese banks to go abroad to London and New York in search of profitable arbitrage, especially in bond markets. By 1986 Japanese banks were the biggest lenders in international financial markets.

From this period, the Japanese surpluses continued to be invested through the US and the financial markets in Tokyo became interlinked with financial and economic circumstances in the US and UK. Strong and skilful intervention by the state of Japan averted a major crisis that spread through London and New York and became known as Black Monday (in October 1987).

During the late 1980's through until 1999 Japan had imposed a financial transaction tax on a variety of capital trade instruments. The tax was levied through debt and equity positions at differential rates. Implementation of this transaction tax was considered to be very successful and generated revenues of approximately US\$12 billion a year. Rising pressure from the US and the UK forced the Japanese government to withdraw the tax in 1999 as the increasing global deregulation of financial markets under the neoliberalist hegemonic order became entrenched (Singh 2004:4). The Japanese economy is heavily linked to the US and the UK but there is now an alliance with China which dominates the region. Japanese opposition to currency transaction taxes is not as pronounced as the US, but the underpinning nature of their economic ideology is strong.

There is a demonstrated opposition to CTT's from the three most powerful financial market states. Despite recurring global crises in financial markets and the dangers posed by size and volatility in trades, financial markets have helped the US to reproduce its position as a world leader in globalisation. As discussed in this section the power of the US has come from political decisions to open economies to market forces and the creation of structural power driven by alliances through Thatcher and Reagan and then Blair and Bush, with the support of the Washington Consensus.

New York, London and Tokyo lead in a united opposition to the proposals for a tax on financial trades, in defiance of popular support in Europe and South America. The US has effectively blocked debate in the most influential groups including the UN

and the UK has effectively stifled debate in the European Union. There is realistically no immediate prospect of this changing. Hedge funds have been forced by the Securities and Exchange Commission to register their operations in the US, which is a step against the tide.

Helleiner, Strange, Patomaki, Porter, Germain and scores of commentators have questioned the hegemonic role of the US and its coalition with the UK and Japan. The persuasive powers of this coalition must be respected in the current economic climate dominated by neoliberal doctrines.

CHAPTER SUMMARY

This chapter has investigated the political possibilities of introducing a global currency transaction tax and concluded that although there is growing support in many states there is extreme resistance to the proposals from the United States and its close economic allies, the United Kingdom and Japan. However, commitment to join a small but growing number of states who see positive economic and social benefits from a CTT has seen recent resurgence in support, particularly in Europe and South America.

Perceived instability from burgeoning capital markets is reason enough to persuade politicians in many states to at least examine the positive and negative aspects of CTT's. This is rare in times when no massive financial implosions have threatened in the way that the South East Asian decimated the social and economic fragment of the region. Nevertheless there has been a concerted push from Europe, Scandinavia, Ireland and Canada to implement legislation.

In the United Kingdom, Chancellor Gordon Brown has been an enthusiastic supporter of some forms of CTT, as demonstrated in his statement supporting the tax on the attached War on Want DVD (War on Want 2005). It may be that the transition of leadership from Blair to Brown (if in fact this occurs) would open further possibilities for debate on the implementation of a tax.

The offsets for a CTT are the significant amounts of capital revenues that could be utilised for public goods in participating states, poverty considerations in developing non-participating states and most importantly a more accountable and transparent

currency transaction market. As summarised in this chapter there are powerful forces impeding implementation but an equally powerful groundswell of citizens is finding voice for change around the globe. It is conceivable that the current circumstances with tax havens will not change with the possible implementation of a CTT.

Moves are in place in the United States to lightly regulate the hedge fund industry which is the capital engine for the massive currency transaction sector. These moves are meeting with strong opposition from capital traders even as their industry receives negative and derisive comments about significant losses in client's funds and lack of accountability. The outcomes of future debate on the implementation of a CTT will largely depend on the levels of lobbying by civil society; the will and voices of people demanding a more equitable distribution of wealth.

6. CONCLUSION

The German philosopher Schopenhauer once said that a good idea goes through three phases. In the first instance it is ridiculed as nonsense; in the second it is debated and heavily contested; and in the third it is accepted and implemented. The CTT debate has entered phase two by any reasonable critical appraisal. It has been a painfully slow process against the best lobbying available throughout the last decade.

The debate over a CTT has come back on to the global agenda due to growing awareness of two key features of global financial markets. Foremost is the huge rise in the volumes of trade over the past decade, with volumes now averaging over US\$2 trillion per day. Second is that a large proportion of trade takes place in off-shore tax haven venues using the new hedge funds and funds of funds, which make it impossible to accurately assess the true value of current trades and increase the likelihood of a global financial crisis.

Despite growing popular support for a CTT in recent years, circumstances have not been propitious and have enabled opposition groups to deflect and contain the challenge. However, a review of economic history suggests that the “boom” market of the past several years cannot continue forever and that recessions inevitably follow. Financial instability has been high on the political agenda for over two decades. The massive costs and social disruption associated with outwards runs on capital, defaults of government financial institutions and corporate identities all have a profound effect on states and economic markets as a whole. And as we know from the case of the Asian currency crisis, financial instability can have profound political consequences.

Many governments, driven by the orthodoxy of self-correcting markets—ideas that are especially prevalent in the United States—have been unwilling to consider the idea of a CTT. Whilst Belgium, France and Canada have called for the introduction of a CTT, the overall approach in most states has been to take a “wait and see” stance. If pressure for a CTT is growing, however, it is because governments see an opportunity not only to moderate currency market volatility, but also to earn revenue to meet a growing range of international commitments that include the war on terror,

emergency relief (following the Indian Ocean Tsunami), and to Millennium Development Goal projects.

There has never been a more opportune time to re-examine the call for currency transaction taxes. In the latter part of 2004 and the early part of 2005 there have been reinvigorated calls for a CTT. These include Belgian, French and United Nations initiatives. In July 2004, the Belgium Government passed legislation to introduce a CTT. This bold step was followed by a commitment by French President, Jacques Chirac in August 2004 to look at ways that France could introduce a similar tax. The United Nations Secretary General, Kofi Annan, recently held urgent talks on global taxes and Japanese government has also launched enquiries to look at the introduction of the CTT, as has the Finance Minister of India Mr. P. Chidambaram. In the biggest financial centre in the world, Chancellor Gordon Brown from the UK has issued a statement expressing his desire to see its implementation and spoke convincingly on the subject in a War on Want-sponsored promotional video. This commitment has been followed by Spain and Argentina. Momentum is picking up in many OECD countries, with the notable exception of the United States.

The change in sentiment now even sees the leaders of France, Brazil, Spain and Chile express their desire for the immediate implementation of a CTT. In a hastily arranged video link at the 2005 World Economic Forum in Davos, Switzerland, Chirac attempted “to steal Tony Blair’s thunder” by delivering a speech calling for international taxes or levies on global financial transactions. Chirac suggested that this type of tax could raise US\$10 billion per year and echoed France’s previous support over the past decade (*The Economist*, January 29 2005).

While “old Europe” is beginning to support the idea of a CTT, opposition to it endures in the United States, Great Britain and Japan. As described in Chapter five the United States has placed unprecedented pressure on states to oppose the CTT proposals. There, lobbyists have exceptional access to politicians via the porous nature of the US state, and they stress the disadvantages associated with such a tax. Disadvantages they see include a reduction in trading volumes and a loss of business and revenue as traders divert activity to non-CTT compliant states. While these problems are real, they pale in relation to consequences of a systemic currency crisis.

The growing weight of support in favour of a CTT may contribute to a more vigorous debate in the United States. However, as the issues of Iraq and global warming reveal, the US can and will resist changing its policy in the face of overwhelming pressure from other states. Ultimately, therefore, the implementation of a CTT may well need to await the next major currency crisis. Given the growth in volumes and hedge fund instability, it can only be a matter of time.

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GLOSSARY

Autoregressive Conditional Heteroscedasticity (ARCH): The process of determining whether volatility in currency trading markets in one period is related to volatility in earlier periods.

Bailouts: The name associated with rescue packages for financially stricken economies following the flight of capital or financial crisis. Typically, the IMF is associated with bailout packages.

Balance of Payments (BOP): The total of all international transactions, including sales (credits) and purchases (debits), written over a given period of time. BOP includes summaries of current account and capital accounts.

Bank for International Settlements (BIS): The BIS was created at the Hague Conference (1930). It is the international central bank of national central banks. The BIS acts as a lender of last resort for these central banks and its capital is comprised of deposits by these banks, plus some private international financial institutions. The BIS records transactions between global, central banks and draws up banking regulations. Members of developed countries control the board of the BIS. The BIS monitors the Basle Accord of 1988 that established an international, minimum capital requirement for banks (8%), which is a minimum percentage of total assets of a bank that must be fully owned by the bank.

Capital: Input into the economy. Real capital is invested into development, infrastructure and equipment. Finance capital is used in speculation, internally between banks and investors, externally as foreign direct investment, or speculation on currency markets and hedging and derivative deals. Human capital is the economic value of people's skills and knowledge whilst social value is the worth and value of communities and human participation in economies.

Capital Account: Register of a country's balance of payments statement which totals all international purchases and sales of assets, including foreign direct investment, portfolio investment, bank loans, other securities and foreign currency holdings.

Capital Controls: Capital controls include measures taken, enacted or mooted to control foreign exchange transactions in order to manage capital flows.

Capital Flows: The movement of foreign exchange from one country to another, including bond issues, currency speculation, derivative dealings, capital repatriation, foreign direct investment, portfolio investments, and inter-bank exchanges.

Central Bank: The central bank of a nation state (controlled by a national governing body), is responsible for issuing currency, setting monetary policy, interest rates and exchange rate policy, as well as the regulation and supervision of the private banking sector.

Continuous Link Settlement (CLS) Bank: The CLS Bank was the first international settling utility which dealt in foreign exchange transactions and had over 55 member central banks and 110 member customers.

Currency Futures: Currency futures are contracts for future delivery of a specified unit of foreign currency, at a fixed price, at a specified date. Futures contracts are in standard amounts, whereas forward contracts are once-only transactions.

Currency Options: Give the right to buy and/or sell a currency with another currency at a specified exchange rate, during a specified period or on a specified date.

Currency Transaction Taxes (CTT): Measures introduced by the state to control or tax foreign exchange transactions on a variety of instruments. CTT's are aimed at reducing the volatility of transactions, particularly the outward flow of capital in times of impending crises. Capital controls are also introduced by the State to impose restrictions and to "peg" a currency against another. An example of a "pegged" arrangement currently (2004) exists between the United States and China.

Currency Swaps: Transactions where counterparties exchange and re-exchange, both principal and streams of, fixed or floating interest payments in two different currencies.

Current Account: The section of a country's balance of payments statement, which totals: international transactions for import and export payments; interest on debts; profits from foreign, direct investment; and, aid grants. It is a broad measure of a country's trade balance (a negative current account balance = a trade deficit).

Debt Standstill: The temporary cessation of debt repayments designed to allow countries to reorganise and reschedule their debt repayment obligations.

Derivatives: A type of financial instrument whose value is 'derived' from the price of some underlying asset (e.g. an interest level or stock market index). Derivatives are designed to help companies "hedge" (protect themselves against the risk of price changes) or as speculative investments from which great profits can be made. The rapid growth in derivatives trading has played a major part in the growing volatility of the global financial system.

Devaluation: The drop in the value of one currency relative to another. Developing countries have often been encouraged to devalue their currency as part of IMF / World Bank structural adjustment programs as a means of increasing the costs of imports and decreasing the cost of exports, thereby increasing competitiveness. A problem with such speculative runs, from the point of view of the target country (under the eye of speculators), is that the devaluation tends toward self-fulfilment as behaviour based on the expectation of devaluation creates an actual devaluation.

Exchange Rates: The price of one country's currency relative to another (e.g. \$1AU = \$.67 US.) Exchange rates can be managed according to three basic systems – floating, fixed or pegged (China and the United States).

Exchange-traded contracts: Cover trade in a number of foreign exchange products through organised derivatives exchanges. US exchanges account for around 90% of trading in foreign exchange contracts.

Foreign Exchange (forex) Swaps: Involve the exchange of two currencies on a specific date and a reverse exchange of the same two at a date further in the future, at an agreed rate at the time of the contract.

Fiscal Policy: Government macroeconomic policy that seeks to influence general, economic activity through control of taxation and government spending (see also monetary policy).

Foreign Direct Investment (FDI): The purchase of land, equipment or buildings, or the construction of new equipment or buildings, by a foreign company. FDI also refers to the purchase of a controlling interest in existing operations and businesses (known as mergers and acquisitions). Multinational firms seeking to tap natural resources, access lucrative or emerging markets, and keep production costs down by accessing low-wage labour pools in developing countries, are FDI investors. Classic examples of FDIs include American banks taking over Korean ones and Canadian mining companies building mines in Brazil. (See also portfolio investment)

Foreign Exchange: Foreign exchange is currency issued by a foreign, nation -state government. Foreign exchange is required to pay for imported goods and to meet foreign debt repayment obligations. Most trade in foreign currencies occurs between large, international banks. Unlike stock markets, the “foreign exchange market” does not exist in any specific location. A large proportion of the foreign exchange market is carried out from more than eighty tax shelter havens, which have been established specifically for unregulated trading and tax avoidance. Foreign exchange swaps are transactions where one currency is swapped for another and then swapped back at a pre-agreed rate on a pre-arranged date.

FRAs (Forward Rate Agreements): Are an interest rate forward contract, determined at contract initiation.

Funds of Funds: The accumulated funds from hedge funds that are then used as collateral to leverage further funds from banks. The gross amounts (sometimes on a highly leveraged ratio) are then reinvested with hedge funds. Funds of funds are seen as the highly speculative cousin of hedge funds and have the potential for considerable disorder in financial markets.

G-20: A group composed of the Finance Ministers and central bankers of the following 20 countries: Argentina; Australia; Brazil; Canada; China; France; Germany; India; Indonesia; Italy; Japan; Mexico; Russia; Saudi Arabia; South Africa; South Korea; Turkey; the United Kingdom; the United States of America; and, the European Union. The IMF and the World Bank also participate. The G-20 was set up to respond to the financial turmoil of 1997-99 through the development of policies that “promote international financial stability”.

Globalisation: The term globalisation refers to the increasing, economic integration and interdependence of countries. Economic globalisation in this century has proceeded along two main lines: trade liberalisation (the increased circulation of goods) and financial liberalisation (the expanded circulation of capital).

Hedge Funds: A private, unregulated investment fund for wealthy investors (minimum investments typically begin at US\$1 million), specialising in high risk, short-term speculation on bonds, currencies, stock options and derivatives. The accumulated funds of hedge funds are now the leading instrument in highly leveraged financial markets.

Hedging: In its simplistic form, the purchasing of foreign exchange in anticipation of future price changes. Hedging is an increasingly necessary business expense in times of high exchange rate volatility.

Herd Behaviour: Herd behaviour is the tendency of investors to behave as a homogenous group in response to rumoured market changes. This leads to panic in moments of crisis and the sudden withdrawal of enormous quantities of investment from countries suddenly perceived to be vulnerable to collapse (a phenomenon known as capital flight).

High Net Worth Individuals (HNWI): Individuals who principally deal at the high end of the capital speculation markets in currencies and hedge funds. HNWIs had a big year in 2004, increasing wealth by 7.7% to \$US 28.8 trillion.

Homo-Economicus: The “slang” name given to the new, wealthy and mainly young, male currency and hedge fund traders, seen to be at the cutting edge of the “rich at any expense” layer of people who are currently enfranchised by de-regulated financial trading, and are quite often from privileged backgrounds and circumstances.

Hot Money: The name for short-term, speculative capital that makes up the greater percentage of all foreign currency transactions. The relative turnaround for “hot money” can be under twenty-four hours. Some “hot-money” trades on international sell and buy mechanisms in even smaller timeframes.

IMF (International Monetary Fund): An international organisation, established in 1944, to provide short-term, financial assistance to countries needing to stabilise exchange rates or alleviate balance of payments difficulties. Since the 80s, the IMF has becoming increasingly involved in the economic decision-making of nations through the conditionality associated with its loans.

Interest Rate Swaps: Are agreements to exchange periodic payments related to interest rates on a single currency. They can be fixed -for-floating, or floating-for-floating, based on different indices.

Interest Rate Options: Give the right to pay or receive a specific interest rate on a predetermined principle for a set period.

International Financial Architecture: A phrase for the policies, administrative structures, programmes and institutions required to manage the increasingly globalised world of finance.

Lender of Last Resort: An institution, usually a central bank, that can step in and lend funds to a bank facing a panic (sudden withdrawal of funds by depositors), or when no other institution will lend to an institution which is considered high-risk or near collapse.

Liquidity: The availability of sufficient resources to meet payment and obligation needs.

Monetary Policy: Government macroeconomic policy that seeks to influence general, economic activity by controlling credit and interest rates, and the domestic money supply (i.e. the amount of currency in circulation).

Moral Hazard: A term based on the principle that if people are allowed to escape the consequences of their risky actions they are more likely to engage in reckless behaviour in future. The moral hazard argument is often used to dispute the granting of forgiveness of legally contracted debt; it has also been used to criticize IMF rescue packages, which bail out reckless bankers and private investors.

Mutual Fund: A collection of stocks, bonds or other securities owned by a large group of often-small investors and managed by a professional fund manager.

Outright Contracts: Straight-forward exchanges of one currency for another that are conducted on the Interbank market. Outright Contract settlement dates and rates can vary between those of spot and forward transactions. Spot transactions settle two business days after the deal date and the rate is the current market price. Forward transactions are settled on any pre-agreed date three or more business days after the deal date.

Over the Counter (OTC): An OTC option is a contract that gives the holder the right, but not the obligation, to buy or sell a currency at a specified price within a specific time frame. OTC currency options are customised options where no clearing house stands between the two parties.

Outright Forwards: Share a similarity to spot transactions but are transacted at a price more than two business days after the deal was negotiated.

Pension Fund: Similar to a mutual fund, except investors are long-term and bound by some common, workplace affiliation (such as a union). In many countries, pension funds represent the largest single institutional investors.

Portfolio Investment: Refers to the purchase of foreign stocks, bonds or other securities. In contrast to FDI, foreign portfolio investors have no controlling interest in the investment, which is typically a short-term one. The relative ease with which portfolio investments can enter and exit countries has been a major contributing factor to the increasing volatility and instability of the global financial system.

Reserves: The amount that banks are legally required to keep ‘on hand’ to meet short-term repayment obligations (for instance, if a large percentage of depositors suddenly decide to withdraw their money). The amount banks are required to keep in reserve varies by country and has generally declined over time through the process of financial liberalisation.

Securities: Financial instruments (such as bonds or stocks) that can be traded freely on the open market.

Securitisation: Refers to the pooling of loans or assets for subsequent sale to investors.

Speculation: Can include the act of betting on changes in exchange rates in the hope of profiting. A speculative “attack” occurs when a large number of investors anticipate a reduction in currency values and sell off large quantities of their holdings (thereby often creating the price crash they predicted). Speculators often work for major banks and investment firms.

Speculative Investment: Refers to money invested in highly liquid instruments based on an expectation of the price, or the currency value, to increase or decrease, thus creating an opportunity for selling at a profit (known as arbitrage). Speculation often involves attacks on currencies that are expected to devalue.

Spot transactions: Cash transactions negotiated within two working days.

Tobin Tax: A proposal by Nobel-prize winning economist, James Tobin, to place a small tax on all foreign, exchange transactions as a means of stabilising currency markets. The tax would also generate hundreds of billions of dollars annually.

Volatility: The tendency of financial markets to change abruptly at the whims of investors. As national control over financial markets fall, as a result of capital account liberalisation and the volume of portfolio investment skyrockets, volatility is increasing in financial markets. While unstable markets are profitable for speculators (see speculation), the real economy cannot function properly when exchange rates are fluctuating wildly and capital is flowing in, and more often out, of a country in tidal waves.